

No. 92-466-CFX Title: Brooke Group Ltd., Petitioner
Status: GRANTED v.
Brown & Williamson Tobacco, Corporation

Docketed: Court: United States Court of Appeals for
September 16, 1992 the Fourth Circuit

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1	Sep 16 1992	G	Petition for writ of certiorari filed.
2	Oct 16 1992		Brief of respondent Brown & Williamson Tobacco Co. in opposition filed.
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4	Oct 23 1992	X	Reply brief of petitioner filed.
6	Nov 9 1992		REDISTRIBUTED. November 13, 1992
7	Nov 16 1992		Petition GRANTED. *****
8	Dec 31 1992		Joint appendix filed.
		*	Joint appendix in three volumes
9	Dec 31 1992		Brief of petitioner Liggett Group, Inc. filed.
10	Jan 13 1993		Record filed.
		*	Partial proceedings United States Court of Appeals for the Fourth Circuit.
11	Jan 28 1993		Record filed.
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13	Feb 3 1993		SET FOR ARGUMENT MONDAY, MARCH 29, 1993. (2ND CASE).
14	Feb 3 1993		Brief of respondent Brown & Williamson Tobacco Corporation filed.
15	Feb 3 1993		Brief amicus curiae of ITT Corporation filed.
16	Feb 3 1993		Brief amicus curiae of Grocery Manufacturers of America, Inc. filed.
17	Feb 3 1993		Brief amicus curiae of Business Roundtable filed.
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21	Mar 29 1993		ARGUED.

92-466

No. 92-

Supreme Court, U.S.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1992

LIGGETT GROUP INC., now named Brooke Group Ltd.,
Petitioner,

vs.

BROWN & WILLIAMSON TOBACCO CORPORATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In a highly concentrated industry with long maintained supracompetitive prices and profits, the jury found that respondent's admitted price discrimination had a reasonable possibility of injuring competition in violation of the Robinson-Patman Act. Substantial evidence showed that respondent succeeded in raising prices, having expressly undertaken to harm consumers by disciplining a price-cutting rival through sustained discriminatory pricing below cost, after an express and accurate analysis of how it would recoup its predatory investment. The court of appeals immunized these acts. In its view of "economic logic," such disciplinary pricing was implausible because only a monopolizing or conspiring predator could ever recoup its investment in below-cost disciplinary pricing. The case presents the following questions:

1. Does the Robinson-Patman Act's prohibition of price discrimination that "may substantially lessen competition or tend to create a monopoly or injure . . . competition with [the discriminating seller]" retain independent force or does it address only a monopoly or conspiracy already covered by the Sherman Act?
2. May a court's "theoretical speculation" about the rational calculations of a hypothetical oligopolist vitiate a jury verdict based on the calculations, conduct, and success of the actual respondent?
3. Even accepting the Court of Appeals' erroneous conclusion that consumers were not injured, must actual injury to consumers -- as distinct from a reasonable threat of injury -- be demonstrated before Robinson-Patman Act liability can be found?

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**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE
FOURTH CIRCUIT**

Liggett Group Inc. ("Liggett"), now named Brooke Group Ltd.¹, petitions the Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit is reported at 964 F.2d 335 (4th Cir. 1992), and reprinted at Petitioner's Appendix ("Pet. App.") 1a. The opinion of the United States District Court for the Middle District of North Carolina granting judgment notwithstanding the verdict for respondent Brown & Williamson Tobacco Corporation ("B&W") is published at 748 F. Supp. 344 (M.D.N.C. 1990), and reprinted at Pet. App. 17a. The opinion of the District Court denying summary judgment for B&W is published at 1989-1 Trade Cas. (CCH) ¶68,583 (1988).

JURISDICTION

The Court of Appeals entered judgment on May 11, 1992 and denied petitioner's petition for rehearing and suggestion for rehearing *in banc* on June 18, 1992. Pet. App. 15a. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTE INVOLVED

The statutory provision involved in this case is Section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a) (reprinted in full at Pet. App. 54a), which provides in relevant part:

¹ Pursuant to Supreme Court Rule 29.1, petitioner provides the following corporate information. Brooke Group, Ltd. is a publicly owned corporation which holds a controlling interest in New Valley Corporation. Brooke Group, Ltd, has no parent corporation.

It shall be unlawful for any person . . . to discriminate in price . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce . . . or injure, destroy, or prevent competition with any person who . . . grants . . . such discrimination. .

STATEMENT

This case presents the issue of whether respondent's admitted price discrimination had a reasonable possibility of injuring competition. The Fourth Circuit held that, absent a conspiracy, an oligopolist could never be sufficiently certain of a pay off to threaten competition. It therefore limited liability under the Robinson-Patman Act for predatory price discrimination to instances where the defendant is a monopolist or conspirator. The Fourth Circuit disregarded both a sophisticated defendant's own analysis that its below-cost price discrimination paid off and Congress' explicit judgment that competition could be hurt by price discrimination by a firm that is neither a monopolist nor conspirator. By substituting an idiosyncratic and illogical view of economic theory for the mandate of the Robinson-Patman Act, the Fourth Circuit decision conflicts with decisions of this Court and other circuits. By immunizing an oligopolist's price discrimination, which is an effective tactic for disciplining maverick price cutters, the Fourth Circuit invites disciplinary pricing.

1. *Legal Context.* Although amended by the Robinson-Patman Act in 1936 (mainly in other respects), the statutory provision at issue here was part of the 1914 Clayton Act, which was designed to condemn conduct not already reached by the 1890 Sherman Act. The original Clayton Act provision focused on a seller's price discrimination that might impair "primary line"

competition -- that is, competition between a seller and its rivals.² This is a primary-line case. The test of legality is whether the effect "may be substantially to lessen competition or tend to create a monopoly." 15 U.S.C. §13(a). According to this Court, price discrimination with a "reasonable possibility of injury to competition" is unlawful. *See Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685, 698, 701 (1967). The jury was instructed accordingly.

Through the 1960s, claims of primary-line injury were usually left to juries under vague instructions inviting them to condemn price discrimination "intended" to injure competition.³ *Utah Pie* endorsed this approach.

Beginning in the late 1970s, lower courts came to understand that price cuts are often a means of legitimate competition and that even discriminatory cuts do not injure competition among manufacturers unless they are "predatory." Since then, courts have typically tested prices against costs -- usually average variable costs -- to distinguish improper pricing from legitimate competition under both the Robinson-Patman Act and Sherman Act § 2.⁴ Those courts stating the Robinson-Patman test in terms of

² The much criticized 1936 amendment focused on "secondary-line" competition among the recipients of discriminatory prices; it sought to discourage a supplier from favoring chain stores and other large retailers over the smaller dealers competing with them.

³ For a summary of such Robinson-Patman cases, see generally E. Kintner and J. Bauer, 3 *Federal Antitrust Laws* at 276-289 (1983).

⁴ Sherman Act §2, 15 U.S.C. §2, makes it unlawful for any person to "monopolize, or attempt to monopolize . . . any part of trade or commerce among the several states." Sherman Act § 2 is reprinted in full at Pet. App. 54a.

predatory intent infer it from below-cost pricing,⁵ and some courts have supplemented price-cost tests with intent evidence.⁶

Recently some courts have also asked whether it is possible for the alleged predator to "recoup" the losses resulting from below-cost pricing.⁷ Recoupment is simply the payoff for below-cost pricing. In the standard monopoly predation model, one firm voluntarily incurs losses by selling a product for less than its variable cost in order to ruin rivals, gain a monopoly, charge monopoly prices, and earn monopoly profits recouping those earlier losses. This case poses the questions (i) whether, as a matter of law, only a monopolist (or organized cartel) would think recoupment likely enough to undertake unjustified below-cost pricing, and, therefore, (ii) whether an oligopolist's sustained and unjustified discriminatory prices below average variable cost never creates a "reasonable possibility of injuring competition."

2. *Factual background.* Until 1980, all cigarettes were sold at the same price by the six cigarette manufacturers. A5605-08, A5774, A5777, A5923-4.⁸ In the words of B&W's President, "[o]ne key on the cash register rang up all cigarette sales." A2204, A5948-49. In classic oligopolistic fashion, one company would raise its prices and the other five would follow immediately. These lock-step price increases happened regularly and often, even when the demand for cigarettes and the price of tobacco fell. A5608-09, A5791-93, A5946-47, A6003-05, A6324-33. Profits

⁵ E.g., *Double H. Plastics, Inc. v. Sonoco Products Co.*, 732 F.2d 351, 354 (3d Cir.), cert. denied, 469 U.S. 900 (1984); *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1040-41 (9th Cir. 1981), cert. denied, 459 U.S. 825 (1982).

⁶ E.g., *McGahee v. Northern Propane Gas Co.*, 858 F.2d 1487 (11th Cir. 1988), cert. denied, 490 U.S. 1084 (1989).

⁷ E.g., *Henry v. Chloride, Inc.*, 809 F.2d 1334 (8th Cir. 1987). Cf. *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396 (7th Cir. 1989), cert. denied, 494 U.S. 1019 (1990) (Sherman Act § 2).

⁸ These and subsequent factual citations, beginning "A," are to the Fourth Circuit Appendix.

have been supracompetitive and among the highest of any industry, and entry barriers have precluded successful new entry for more than fifty years.⁹ A6357-78, A6381-87, A3216.

In 1980, plaintiff Liggett -- in defendant B&W's words -- "was on the verge of going out of business" and "made the bold move" of introducing a generic cigarette in a black-and-white package at a substantial price discount. *Id.* B&W's senior executives noted in corporate documents that Liggett's move was "the first time that a cigarette manufacturer has used pricing as a strategic marketing weapon in the U.S. since the depression era." A1417. Liggett's black-and-white generics were deeply discounted, originally at prices 30% below branded cigarettes. By mid-1984, the discount grew to 40% as Liggett declined to raise black-and-white prices as fast as regular cigarette prices. A1295; Pet. App. 6a.

By mid-1984, Liggett's black-and-white cigarettes accounted for 4% of the entire cigarette market (A3049), 97% of all reduced-price cigarettes (A1221), and about 60% of Liggett's total sales (A1335).¹⁰ The other cigarette manufacturers, according to

⁹ B&W's economic experts agreed with most of the evidence upon which Liggett's expert relied for this conclusion, A6334-35, A6344-56, A6386-88, A7010-11, A7006-08, A7764-66, which was also supported by scholarly writings in the record. See note 19 *infra*. Without discussing this market's non-competitive history, the opinion below noted the testimony of Liggett executives that the industry was "competitive" during the "price war." But "business people . . . view competition" not in its economic sense as the rivalry that eliminates supracompetitive prices and profits, but "as the conscious striving against other business firms for patronage." F. Scherer and D. Ross, *Industrial Market Structure and Economic Performance* 16 (3d ed. 1990).

¹⁰ During the relevant time period, reduced-price cigarettes were almost entirely black and white. As for the others:

In 1983 two companies, B&W and Reynolds, started including 25, instead of 20, cigarettes in each pack of their respective Richland and Century brands, which were sold at full price. As B&W noted, these so-called "25s" are "not a direct, effective defense against generic growth."

B&W's internal analysis, were concerned that black-and-whites would not attract new buyers but would "cannibalize" high-profit brand name sales. A2066. They were also concerned that "unchallenged, [Liggett] will continue aggressive segment development since it has virtually no stake in the branded, full price market." A1341.

B&W was hardest hit. Over one-fifth of Liggett's generic cigarette consumers had previously patronized B&W brands, even though B&W's share of the cigarette market was 12%. A1420-21. B&W calculated prior to its entry that continued growth of black-and-white cigarettes would cost it \$350 million in lost revenue by 1988. A1341.

On May 31, 1984, B&W announced that it would introduce a black-and-white cigarette by mid-July. A4410. That cigarette was intentionally packaged to look as much like Liggett's as possible. A1272, A1213. B&W's stated goal was to "gradually reduce [the] percent difference between generics and full revenue

A1346. B&W's president did not even consider 25s to be generic cigarettes. A2211. Another B&W document stated, "25s are not the answer to generics." At the time of trial in 1989, 25s represented less than 1% of all cigarette sales. A5389.

In May 1984, R.J. Reynolds reduced the list price of one of its brands, Doral. However, Doral did not become significant until 1985, when its market share reached 1.3%. A2966. Doral, and other "branded-generic" cigarettes introduced in and after 1986, were not considered as threatening to profits as black-and-whites: Reduced-price brand-name cigarettes carry less of a price-discount message than black-and-whites and have greater brand loyalty, and thus their price can be more easily increased. A1420. For example, Reynolds did not think it necessary for Doral to follow B&W rebates on black-and-whites.

Although Philip Morris and Reynolds ultimately introduced black-and-white generics in 1986 and 1988 respectively, they focused on private label sales, and their combined black-and-white market share was less than one-half of one percent at the time of trial. A5928-29, A5399.

brands."¹¹ A2403. See also A1270-1271, A6130-35, A1321. Once that price gap was reduced, B&W reasoned, consumers would be less willing "to trade-off image for price." A1322. B&W planned to bring about higher prices by offering discriminatory rebates targeted at Liggett's largest wholesale customers and thus forcing Liggett to offer comparable rebates, thereby suffering large losses until it raised list prices, which would mean higher consumer prices. A1827, A1676, A1813. B&W calculated that Liggett lacked "the financial resources of others in the industry," is thus "unlikely" to "engage in a sustained battle," and therefore "will try to survive by raising prices on generics." A1363, A1865. B&W accurately predicted that Liggett's parent company, which was trying to sell Liggett, would not tolerate indefinite losses and eventually would raise list prices as the only way to return to profitability. A1827, A6229. B&W's strategy was not necessarily to destroy Liggett or kill generics, but to weaken Liggett's commitment to hold down black-and-white list

¹¹ Although it is customary and convenient to refer to B&W's intent as reflected in the documents prepared and used by B&W's senior officials, petitioner does not contend that B&W's anticompetitive motive in itself violates the statute. Rather, the "intent" evidence resolves any ambiguity in B&W's conduct; it has told the court what it is up to. The "intent" evidence reveals a sophisticated actor's own market analysis and predictions about how that market works and the potential for a profitable payoff from disciplinary pricing. See *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918) ("knowledge of intent may help the court to interpret facts and to predict consequences").

According to the District Court, anticompetitive intent was documented more clearly than in any known case. Pet. App. 31a. The Fourth Circuit opinion said nothing about B&W's intent except twice to quote the same sentence from a B&W document, implying that B&W may have abandoned any previous anticompetitive intent when R.J. Reynolds introduced a generic-priced cigarette named Doral. Pet. App. at 4a-5a. However, B&W stated after the introduction of Doral that its intent had not changed and that its entry would be "alike in every way to the original proposition. . .," and subsequent B&W documents reiterated B&W's anticompetitive intent. A1412, A1667, A1769. See also *Liggett Group, Inc. v. Brown & Williamson Tobacco Corp.*, 1989-1 Trade Cas. (CCH) ¶68,583 (1988) (providing a comprehensive summary of the B&W intent documents).

prices. With Liggett's commitment thus reduced, B&W would then be free to raise black-and-white prices, and thus "reduce" the "percent difference between generics and full revenue brands." A6130, A4376. As a result, consumers would pay higher prices for all cigarettes, both branded and generic.

For eighteen months after its entry, B&W repeatedly paid large volume-based rebates on black-and-white cigarettes, resulting in net prices that varied discriminatorily among wholesalers and that were well below B&W's average variable cost, as B&W had planned from the outset.¹² A7003, A7799. For eighteen months in 1984 and 1985, B&W's generic revenues were \$14.9 million (30¢ per carton) below its average variable costs. A6547, A6704, A3094-3196, A6272. The jury found that B&W's below-cost pricing was not legitimately introductory or promotional. Instruction No. 27, A7952.

According to B&W's own strategic documents, price discrimination was integral to its predatory plan. A1248, A1348, A1745. It assured its parent company that its pricing of black-and-whites to wholesalers would not have the undesired effect of expanding demand for generic cigarettes. A1244. Rather than reduce list prices, B&W explained, it would grant discriminatory rebates to wholesalers, who would be unlikely to pass the savings on to consumers and who mainly did not do so. A1765. The rebates were often paid months after the cigarettes to which they applied had been resold. A4420. As B&W explained:

¹² The Fourth Circuit quoted a B&W document planning to sacrifice no more than "full variable margin." Pet. App. 5a. However, under B&W's accounting system, sacrificing full variable margin meant a price below average variable cost. A7044-48. Moreover, both B&W experts conceded that on a pre-tax basis B&W priced its black-and-whites below their average variable cost for eighteen months in 1984 and 1985. Because these losses partially offset company profits gained from other sales -- whether branded cigarettes for B&W or biscuits -- and therefore reduced B&W's federal income taxes, it unsuccessfully urged the court and jury to count such tax savings (and other alleged income tax savings) as if they were generic revenue, which could then be presented as exceeding variable costs. See *Liggett*, 1989-1 Trade Cas. (CCH) ¶ 68,583 (1988) at 61,107-08 ("The Court has found no case law or legal literature that supports B&W's position").

[T]he B&W proposal is based on offering greater discounts, not reducing the list price. Since retail pricing is based on list prices, B&W's generics will not enhance the price/value relationship of present generics. A1765, A1244.

Moreover, B&W believed that discrimination could discipline Liggett at least cost to B&W because it would "[a]chieve maximum desired volume through a minimum number of customers," thus reducing B&W's investment in its anti-competitive scheme. A5742.

B&W carefully analyzed the likely responses of its fellow oligopolists. It concluded (1) that its larger rivals would not price below cost in order to discipline Liggett for fear of antitrust liability (A1335, A1353, A1354); (2) that they would not forsake the industry's long-standing oligopoly pricing (A1419-20); (3) that they had no incentive or desire to keep prices as low as Liggett at the expense of their very large shares of higher priced cigarettes (A1341-42); and, therefore, (4) that disciplining Liggett would pay off (A1341). To be sure, B&W forecast that other manufacturers would be "quite likely" to "introduce branded generics, develop loyal franchises, and then gradually raise prices over the longer term" so that they could "participate" in the generic segment "in order to manage prices and profitability upward."¹³ A1419-20. To ensure that Philip Morris and R.J. Reynolds did not mistake B&W's goal and unintentionally interfere with B&W's objective of managing the price of generic cigarettes upward, B&W decided to "signal intent to competition" that its entry would "not expand segment." A1278. Rebates rather than lower list prices have that effect.

¹³ For example, B&W predicted that R.J. Reynolds would enter the segment but "would strive to limit the [generic] segment development since incremental generic growth will disproportionately reduce RJR's total margins." A1345. B&W also believed that the industry leader, Philip Morris, "will not take a leadership position in the low margin brand marketing." A1862.

True to its prediction, B&W succeeded in disciplining Liggett. Liggett spent \$89.6 million trying to meet B&W's below-cost, discriminatory rebates to wholesalers. A6149-60. By June, 1985, Liggett could no longer afford the losses thus inflicted on it, but neither could it afford to forfeit its remaining generic business by ceasing its efforts to meet B&W's rebates. A6241-42, *see also* A5906-19. B&W wrote, "Liggett will try to survive by raising prices of generics." A1865. Just as B&W predicted, Liggett raised the list price of its generics, and consumer prices rose. A1865. B&W matched that price increase in October 1985.¹⁴ In December 1985, Liggett resisted B&W's attempt to lead price increases. Thereafter, a disciplined Liggett followed B&W's price increases on black-and-whites.

In June 1986, December 1987, and again in June 1988, B&W led generic prices up at a faster rate than general cigarette price increases. A2887, A2889-90, A2893, A2896, A2898. Although other manufacturers entered the black-and-white segment in 1986 and 1987, as B&W predicted, they were happy to shrink the discount, and B&W's internal documents take credit for disciplining Liggett and reducing the attractiveness of generics. A1667. As an R.J. Reynolds executive testifying at B&W's behest admitted, the industry was managing prices and profitability upward by 1987. A7896-97. The price differential between generics and brand-name cigarettes declined from almost 40% in 1985 to 26.8% in 1989.¹⁵ Pet. App. 6a, A4312, A4280-81. As a result, the prices of both brand-name cigarettes and generics increased dramatically in classic oligopolistic fashion. In 1988,

¹⁴ The delay, according to B&W documents, was designed to increase its volume so that it would be in a stronger position to manage black-and-white prices upward. A2182.

¹⁵ In December 1988, Liggett introduced a new "subgeneric" brand, Pyramid, with a list price approximately 50% below regular brands; two other manufacturers responded with competing entries. A4312. At the time of trial in late 1989, subgeneric sales were less than 1% of all cigarette sales. A5389, A5399. Although Liggett thus reintroduced price competition in December 1988 -- when renewed predation was unlikely because this case was underway -- B&W's conduct at least reduced the discounts available to consumers during 1986, 1987 and nearly all of 1988.

generic prices were higher than brand-name prices had been at the time B&W entered the generic segment -- a phenomenon that cannot be attributed to increased costs or inflation. A7817-18, A6334-35, A6344-56.

B&W informed its corporate parent approximately one year after entering the generic segment, that its strategy had succeeded in slowing the rate of growth of the generic segment. A1667, A1767. By the time of trial in late 1989, the black-and-white segment had dropped to 2.7% of total cigarette sales. A4274. Although reduced-price brand name cigarettes (branded generics) accounted for 10.66% of the cigarette market by the end of 1989, they did not provide an effective brake on increasing cigarette prices. *See* A5399, A4312. Just as B&W had predicted, the other manufacturers did not interfere with B&W's efforts to reduce the discount from brand-name prices because the other manufacturers had the same desire as B&W "to manage prices and profitability upward." A1419-20. B&W recognized that the "future growth of generics will be driven by consumer demand" responding to the price discount and "not by the number of manufacturers who supply those products." A1370.

3. *Proceedings below.* The jury returned a verdict for Liggett. As required under Instruction No. 12, the jury found that B&W engaged in "loss creating price cutting," that there was a "real possibility" of "recoup[ing] such losses" from "prices higher than competitive levels," and thus that B&W's discriminatory, below-cost pricing had a "reasonable possibility of injuring competition in the cigarette market as a whole." A7940-42. The jury was specifically instructed that "[t]he Robinson-Patman Act was designed to protect competition rather than just competitors" and that Liggett "cannot satisfy this element simply by showing that they were injured by Brown & Williamson's conduct." *Id.*

In August 1990, the District Court granted B&W judgment notwithstanding the verdict. The District Court found that the evidence of B&W's anticompetitive [purpose] was "more voluminous and detailed than any other reported case," revealing an intent to harm both Liggett and consumers. Pet. App. 31a. Nevertheless, the court held that B&W "could not have had a reasonable possibility of injuring competition" because there was no "economically plausible way to recoup its losses." Pet. App. 32a. Although the District Court recognized the theoretical

possibility that recoupment could take place in an oligopoly setting, it did not credit the jury verdict that profits were supracompetitive, and it reasoned that without supracompetitive profits, disciplining Liggett would merely cause B&W to lose money without any payoff. Pet. App. 33a. The District Court further concluded that there was insufficient "alignment of interest" among the cigarette oligopolists to allow the price gap between branded and generic cigarettes to narrow. Pet. App. 36a.

The Fourth Circuit affirmed, though on different reasoning. It ruled that recoupment by an oligopolist is never a realistic possibility. Without denying the factual basis for the jury's conclusion that B&W acted predatorily to discipline Liggett and injure consumers, the court ruled as a matter of law that it would have been irrational for an oligopolist to have so acted. According to the court's "economic logic," only a monopolist (actual or prospective) or a member of an organized cartel could profit from charging below-cost prices to discipline a rival: An oligopolist's below-cost investment in disciplinary pricing could never pay off because an alleged predator could never be "certain" that fellow oligopolists would (1) understand that it was disciplining a maverick rather than attempting to expand its own market share, (2) refrain from trying to expand their own market shares, or (3) continue the preceding oligopolistic pricing pattern of prior decades. Pet. App. 11a. The Fourth Circuit believed that its theoretical speculation was confirmed in "hindsight" by the growth of the generic sector, notwithstanding the reduced generic discount and resulting higher prices for both generic and brand-name cigarettes. Pet. App. 12a.

REASONS FOR GRANTING THE PETITION

If the Fourth Circuit decision is permitted to stand, targeted discriminatory price disciplining by oligopolists will be immune from antitrust liability even when there is evidence of anticompetitive intent, conduct, and effect. In conflict with this Court and with other circuits, the Fourth Circuit created a rule of *per se* legality for discriminatory, below-cost pricing by a sophisticated oligopolist undertaken for the express predatory

purpose and with the demonstrated effect of raising prices to the detriment of consumers.¹⁷

Ignoring B&W's carefully analyzed prediction that its disciplinary pricing would be amply recouped through the supracompetitive profits long maintained in the highly concentrated cigarette industry, the Fourth Circuit invoked its own "theoretical suspicions" to conclude as a matter of "economic logic," unsupported by the record, that only a single-firm monopolist or a cartel could be "certain" below-cost pricing would pay off. Pet. App. 12a. By requiring either single-firm monopoly or a conspiracy, the court made the Robinson-Patman Act's prohibition of primary-line injury redundant of the Sherman Act. This judicial curtailment is directly contrary to the language and carefully stated purpose of the 1914 Congress "to prohibit and make unlawful certain trade practices, which...are not covered by the Sherman Act." S. Rep. No. 698, 63d Cong., 2d Sess. at 2. Indeed, as shown below, p.14-15, disciplinary predatory pricing by an oligopolist may be a greater threat to competition than predation by a monopolist.

By requiring "certainty" of recoupment, the Fourth Circuit seriously misread *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986) (Pet. App. 13a), as permitting the court to substitute its own theorizing for the reasonable expectations of a sophisticated market participant and for the well-supported findings of the jury.

Relying on its view of "economic logic," the court reasoned that an oligopolist could not succeed in recouping its investment, and thus was driven to conclude that success had not occurred (notwithstanding both shrinkage in the generic discount and higher prices). This counterfactual conclusion implicitly holds that lack of success immunizes otherwise unlawful pricing below average variable cost.

¹⁷ Respondent was concerned that Liggett's lower-priced generics would cut into existing markets for higher-priced cigarettes, rather than attract new smokers. The relative inelasticity of demand for cigarettes means that higher prices generally cause smokers to pay more for cigarettes rather than reduce smoking.

These issues of law are important to antitrust policy. While few consumer markets are as concentrated as this one, other high-volume consumer products also bear supracompetitive oligopolistic prices. Oligopolists will be prompt to accept the invitation of the Fourth Circuit to discipline price cutters at the expense of consumers. This Court should grant certiorari to direct that statutory language, policy, and the precedents of this Court not be displaced by dubious economic speculations; and to resolve conflict regarding administration of the Robinson-Patman Act. With a fully developed record and jury verdict, this case is well-framed to focus these questions regarding the role of economic theory to implement, rather than subvert, legislation.

1. *The Fourth Circuit misapplied economic theory to restrict the scope of Robinson-Patman Act liability, violating the Act's language and purpose and conflicting with other courts.*

a. *Unlike the Sherman Act, the Robinson-Patman Act is not limited to conspiracy or single-firm monopoly. Per se immunity for disciplinary price discrimination in the absence of actual or prospective monopoly or express cartelization is inconsistent with the language and purpose of the Robinson-Patman Act. By its own terms, the statute applies to one firm's price discrimination that "may substantially lessen competition or tend to create a monopoly . . . or injure . . . competition with [the discriminating seller]." The Act's reference to single-firm conduct is inconsistent with any conspiracy requirement, and the disjunctive language obviates any monopoly requirement. While Congress thus intended this statute to reach conduct "not covered by the [Sherman Act],"¹⁸ the Fourth Circuit limited Robinson-Patman*

¹⁸ S. Rep. No. 698, 63d Cong. 2d Sess. at 2 (1914). A special House subcommittee established in 1975 to consider proposed amendments to the Robinson-Patman Act which would have limited the Act's reach to that of the Sherman Act, as the court below did, found:

"[t]he predatory price discrimination application of Robinson-Patman reaches those practices which are beyond the scope of the Sherman Act. The proposed revision would emasculate Robinson-Patman in this respect. However, no one has articulated a sound basis for radically limiting the Act's primary-line competition reach." Ad Hoc Subcommittee on

Act coverage of predatory and disciplinary pricing to monopolies and conspiracies already forbidden by Sherman Act §§ 1-2.

Congress' concern with primary-line price discrimination was not misplaced. Disciplinary price discrimination in stable oligopolies cannot be dismissed as a trivial problem. It is *more* likely to occur than monopoly predation. *First*, highly concentrated oligopoly is more frequent than monopoly. *Second*, an industry history of persistent supracompetitive prices without new entrants provides better assurance of a payoff than is available to a would-be monopolist guessing about future entry after prices have become supracompetitive. *Third*, disciplining a competitor is probably quicker than destroying it and thus requires a smaller investment in below-cost pricing. *Fourth*, price discrimination allows a predator to target its price cuts, thereby lowering its investment in below-cost pricing and making recoupment more likely. As B&W put it, a predatory oligopolist can "put the money where the volume is." A-5742. The Fourth Circuit decision encourages just such pricing by any oligopolist that thinks it can profit from it -- without fear of legal liability.

b. *Economic theory does not require conspiracy or single firm monopoly as a predicate for predatory pricing.* The Fourth Circuit panel stated that, in the absence of monopoly or organized cartel, an oligopolist could never be certain that losses from below-cost pricing would pay off and, therefore, it would be irrational to do what B&W did in this case. The court alluded to two possible mechanisms that would prevent such recoupment in an oligopoly: (1) conscious parallelism of an oligopoly is less reliable and more likely to break down than an express conspiracy, and (2) fellow oligopolists might misperceive disciplinary price cutting as promotional and respond with aggressive promotional pricing of their own, frustrating the achievement or maintenance of supracompetitive prices. As to the first, the court did not

Antitrust, The Robinson-Patman Act and Related Matters, Recent Efforts to Amend or Repeal the Robinson-Patman Act, H.R. Rep. No. 94-1738, 94th Cong. 2d Sess. at 76 (1976).

The Subcommittee recommended to Congress that it "should not consider favorably nor take any action on proposals or legislative measures to weaken, emasculate, or repeal the Robinson-Patman Act. . . ." *Id.*

mention the record evidence that, apart from two brief outbreaks of price competition -- one in the 1930s and the other Liggett's black-and-whites -- which were both effectively disciplined, this industry has long been the textbook example of long-maintained supracompetitive prices and profits achieved and maintained without conspiracy.¹⁹ As to the second, the Fourth Circuit acknowledged, "oligopolists might indeed all share an interest in letting one among them discipline another for breaking step and might all be aware that all share this interest." Pet. App. 11a. However, in the panel's view, an oligopolist would never act on such a shared interest because "[t]he oligopolist on the sideline would need to be certain that the others were also confident on the point. Such confidence must be rare More likely, [the other oligopolists] would react competitively." *Id.*

Requiring certainty is misconceived. Not even a monopolist can be certain of successfully recouping by preserving its monopoly. Certainty is also impossible in an express cartel, whose members may "cheat."²⁰ If certainty were a prerequisite to threatened impairments of competition, antitrust law would have no occasion to fear the mergers that create oligopoly or the practices that facilitate its supracompetitive pricing. Yet, antitrust law does prohibit mergers that create or reinforce oligopoly as well as practices that facilitate oligopoly pricing.²¹

¹⁹ See F. Scherer and D. Ross, *Industrial Market Structure and Economic Performance* 250-251 (3d ed. 1990) (A7817-7818) (describing successful price disciplining in the 1930s and the 1980s' experience when despite "the reappearance of low price brands, and falling consumption, the leading U.S. cigarette manufactures raised prices sufficiently to increase their profits from \$3.80 to \$11.55 per thousand cigarettes sold between 1980 and 1988").

²⁰ See *id.* at 238.

²¹ See, e.g. U.S. Department of Justice Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶13,104 (1992) at 20,571 ("in some circumstances, where only a few firms account for most of the sales of a product, those firms can exercise market power, perhaps even approximating the performance of a monopolist by either explicitly or implicitly coordinating their actions"); R. Posner, *Antitrust Law* 40 (1976) ("sellers

Competition can be harmed not because oligopolists are certain of their rivals' reactions, but because each can calculate the gains to be achieved if rivals react in a specified way and then estimate the probabilities that rivals will so behave. In this case, B&W examined each major rival in turn and analyzed how each would react to Liggett's conduct and to B&W's projected plan to discipline Liggett. Directly disposing of the Fourth Circuit's "theoretical suspicions," moreover, B&W memoranda explained that it would "signal [its] intent to competition" that its entry and rebates would "not expand [the] segment." A1278. Discriminatory rebates -- as distinct from list price reductions reaching consumers -- have that effect. B&W concluded (correctly) that its rivals most likely would "enter the new segment to manage prices and profitability upward" to the detriment of the consumer. A1419-20. B&W memoranda also explained how any losses from below-cost pricing -- which turned out to be some \$15 million -- would be more than offset by additional revenues from consumers of \$350 million over the next four years. A1341. As this Court itself recognized in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986), predation is plausible when an investment in below-cost sales can be more than paid back *either* by obtaining "future monopoly profits" or by protecting "future undisturbed profits."²²

The Fourth Circuit said nothing about B&W's own market analysis and predictions that differed dramatically from the court's

might be able to coordinate their pricing without conspiracy in the usual sense There is . . . 'oligopolistic interdependence' . . . in contrast to the explicit collusion of the formal cartel or its underground counterpart"); *United States v. Container Corp.*, 393 U.S. 333 (1969).

²² Quoting R. Bork, *The Antitrust Paradox* 145 (1978). While the Court spoke of "monopoly profits," it did so in the sense of "enough market power to set higher than competitive prices." *Matsushita*, 475 U.S. at 590. See also *Cargill Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 119 n.15 (1986) (acknowledging the plausibility of a nondominant firm engaging in predatory pricing if there was collusion, not just an unlawful conspiracy); *Eastman Kodak Co. v. Image Technical Serv. Inc.*, _____ U.S. _____, 112 S. Ct. 2072, 2086 n.21 (1992) (an oligopolist can "reap supracompetitive prices" by observing and following its rivals).

"theoretical suspicions." See Pet. App. 12a. The speculation of lawyers and judges about potential profits is no substitute for a sophisticated defendant's own carefully designed market analysis and unambiguous plan.²³

c. *Immunizing actual conduct as "implausible" for a hypothetical oligopolist in a generalized, hypothetical market offends Matsushita and good sense.* The Fourth Circuit completely misunderstood this Court's *Matsushita* decision and then based its erroneous conclusion in this case on that misunderstanding. *Matsushita* held that the *existence* of a conspiracy to engage in predatory pricing could not be inferred from circumstantial evidence when there would have been no economically plausible means for the alleged conspirators to recoup any losses from conspiratorial low prices. However, *Matsushita* recognized that an express conspiracy would have been illegal regardless of speculations about its chances of success or about its "rationality" for the defendants. 475 U.S. at 597. Moreover, *Matsushita* declared that "direct evidence of below-cost pricing is sufficient to overcome the strong inference that rational businesses would not enter into conspiracies such as this one." *Id.* at 585 n.9. Contrast the Fourth's Circuit's erroneous statement that

the Court in *Matsushita* held that a conspiracy, which could not hope to recoup its expenses incurred from alleged below-cost pricing and was therefore economically senseless, did not violate the antitrust laws. Pet. App. 9a.

The Fourth Circuit thus declared that *actual* below-cost pricing designed to injure consumers (a key element under the Robinson-Patman Act -- analogous to the Sherman Act conspiracy element in *Matsushita*) is not unlawful because the court deemed success unlikely and therefore concluded that B&W would have been irrational to do what it was proven to have done. Contrary to

²³ "Wisdom lags far behind the market. . . . [L]awyers know less about the business than the people they represent. . . . The Judge knows even less about the business than the lawyers." Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 5 (1984).

the Fourth Circuit, a recoupment requirement serves to eliminate claims grounded on implausible inferences based on ambiguous circumstantial evidence, not to ignore strong evidence.

That a Court of Appeals would so misunderstand *Matsushita* highlights the need to instruct the lower courts that although economic theory can indicate what evidence is required and can therefore illuminate both ambiguous evidence and legal standards, judicial theorizing that conduct is implausible does not trump clear evidence that it actually occurred. *Eastman Kodak Co. v. Image Technical Serv., Inc.*, ___ U.S. ___, 112 S. Ct. 2072 (1992).²⁴ While theory offers several hypotheses about oligopoly behavior, the workings of any particular oligopoly market can be understood only by examining it -- which the Fourth Circuit conspicuously failed to do. Other circuits have not misunderstood *Matsushita* in this regard,²⁵ and this Court should make clear that those other courts represent the authoritative understanding of that case.

²⁴ In *Kodak*, this Court refused to accept the "theory" that a defendant's lack of power in a machine market necessarily precluded power over its unique repair parts. Instead, the Court noted other theoretical explanations of how the defendant without power over machines might obtain supracompetitive prices for its unique repair parts from at least some machine users. 112 S.Ct. at 2085-87. Because the summary judgment record was consistent with the latter theory, the Court found a triable issue. By contrast, the Fourth Circuit held that its theory of impossible recoupment in oligopoly trumped the rival theory *that was supported by the evidence and verdict*. At the very least, therefore, this Court should grant certiorari, vacate the judgment below, and remand for reconsideration in the light of *Kodak*, which appeared after the opinion below, though before denial of reconsideration.

²⁵ E.g., *Arnold Pontiac-GMC, Inc. v. Budd Baer, Inc.*, 826 F.2d 1335, 1338-39 (3d Cir. 1987) (where strong direct evidence exists *Matsushita* has "little or no applicability"); *McLaughlin v. Liu*, 849 F.2d 1205 (9th Cir. 1988) ("It is clear from the *Matsushita* opinion that the Court was not speaking of direct evidence, but of circumstantial evidence. *Matsushita* authorizes an inquiry on summary judgment into the 'implausibility' of inferences from circumstantial evidence, particularly in antitrust conspiracy cases, not an inquiry into the credibility of direct evidence").

d. *The Fourth Circuit's conception of economic logic conflicts with other courts, which are already in disarray.* This Court has never required actual or prospective monopoly or a cartel for a primary-line Robinson-Patman Act violation. It last addressed primary-line injury in *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967). The Court condemned price discrimination without proof of single-firm monopoly or conspiracy and with far less threat to competition than in the present case.²⁶

Utah Pie has not fared well in the lower courts. Indeed, the Seventh Circuit saw "widespread civil disobedience in the judiciary" to that ruling. *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396 (7th Cir. 1989), *cert. denied*, 494 U.S. 1019 (1990). *Utah Pie* has been criticized for excessively weighing intent to harm a rival. The lower courts responded, as did the jury instructions in the present case, by requiring intent to harm consumer interests and by directing jury attention to whether prices were below average variable cost. However, it is only the Fourth Circuit that finds *Utah Pie* so "difficult to understand in the light of recent economic theory," as to demand monopoly or conspiracy for a Robinson-Patman offense. Pet. App. 8a.

Indeed, the contrast between the Fourth Circuit's decision in this case and the Seventh Circuit in *A.A. Poultry* and the Ninth Circuit in *William Inglis & Sons Baking Co. v. Continental Baking Co.*, 942 F.2d, 1332 (9th Cir. 1991), *modified on other grounds*,

²⁶ There, modest evidence of intent to harm a rival by planting a spy in its plant and referring to it as an "unfavorable factor in the market"; here, overwhelming evidence of unambiguous intent to harm both a rival and consumers, an express and sophisticated analysis of how to succeed in doing so, and a declaration of actual success. There, prices below some measure of cost for short periods; here, non-introductory, non-promotional prices below average variable cost for at least eighteen months. There, no entry barriers or persistent oligopoly with supracompetitive prices or other source of recoupment anticipated by defendants or otherwise; here, some \$350 million of recoupment sources by defendant's own calculation. There, no evidence that deteriorating prices injured consumers; here, the relative price of the generic product rose and all prices rose more than costs or inflation. A7817-18, A6334-35, A6344-56.

1992-2 Trade Cas. (CCH) ¶ 69,929 (9th Cir. 1992), reveals a conflict in construing the Robinson-Patman Act. Although the plaintiffs ultimately lost for other reasons in those cases, both *A.A. Poultry* and *Inglis* were entirely ready to find a violation notwithstanding the absence of any monopoly or conspiracy. Moreover, in *USA Petroleum Co. v. Atlantic Richfield Co.*, 1992-2 Trade Cas. (CCH) ¶69, 928 (9th Cir. 1992) at 68,450, the Ninth Circuit held that proof of pricing below cost can establish predation without regard to any monopoly or conspiracy.²⁷

If allowed to stand, the Fourth Circuit decision will create even greater confusion in this area of the law. In doubting the likelihood of predation in the absence of prospective recoupment, courts have spoken in terms of recoupment through post-predation monopoly -- because monopoly is the recoupment route apparent in most cases. *E.g.*, *Henry v. Chloride, Inc.*, 809 F.2d 1334, 1345 (8th Cir. 1987); *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340, 348 (3d Cir. 1981), *cert. denied*, 455 U.S. 1017 (1982). Courts also have adopted a uniform price-cost test for presumptively illegitimate prices under both the Robinson-Patman and Sherman Acts. *Id.* These correct decisions when coupled with the Fourth Circuit's erroneous decision invite a complete coalescence of the two statutes contrary to the intent of Congress and sound antitrust policy.

Liggett does not ask this Court to side with those circuits emphasizing unjustified below-cost pricing alone. Here, the present jury found -- in accord with the instructions, evidence, and economic theory -- below-cost pricing with a prospect of recoupment through supracompetitive prices. Liggett asks this Court to resolve the conflict among the circuits as to the need for the prospect of recoupment under the Robinson-Patman Act and to recognize that recoupment can occur outside of a monopoly or

²⁷ While the Ninth Circuit emphasized an alleged vertical conspiracy fixing maximum resale prices in *USA Petroleum*, that kind of conspiracy cannot aid recoupment when substantial interbrand competition remains both at the supplier and dealer level. The concept of predation was in issue notwithstanding an alleged *per se* violation under Sherman Act §1, because this Court had held that the particular plaintiff could not proceed without proving predation. *Atlantic Richfield Co. v. USA Petroleum Co.*, 459 U.S. 328 (1990).

conspiracy, depending upon the circumstances of the particular market.

Whether or not this Court chooses to retain the full force of *Utah Pie*, this case provides an important opportunity twenty-five years after its last decision in this area to define primary-line injury to competition in the light both of contemporary economic understanding and of a fully developed record. Here, a sophisticated oligopolist (1) expressly undertook to harm consumers by shrinking the price gap between generics and regular brands, (2) accomplished that result by disciplining an admitted price maverick through sustained pricing below average variable cost, (3) after expressly calculating that B&W's investment in such discipline would be recouped out of otherwise threatened \$350 million of brand-name revenue in a concentrated market with long-continued supracompetitive prices and profits and without threat of new entry, and (4) after carefully analyzing the prospective behavior of fellow oligopolists and concluding that they would not interfere with the planned payoff. If this case does not create a reasonable possibility of injuring competition under the Robinson-Patman Act, then any oligopolist is legally free to discipline a price cutter through sustained discriminatory pricing below average variable cost.

e. "Policy" should be debated, not hidden behind false economics. Perhaps the Fourth Circuit's rule of *per se* legality in the absence of monopoly or a cartel could be defended as a bright line that sacrifices Liggett and the consumers hurt by B&W's predatory conduct. They would be sacrificed in order to avoid burdening the courts and the economy with ill-founded claims in other non-monopoly, non-conspiracy situations. However, such an important policy decision should be subject to explicit scrutiny of the pros and cons of limiting Robinson-Patman Act liability to the same coverage as the Sherman Act, and not be obscured by a holding that some notion of economic theory precludes the possibility of disciplinary price discrimination by oligopolists and does so as a matter of law.

2. Requiring actual injury to consumers for a Robinson-Patman Act violation wrongly constrains that law and conflicts with other circuits. The Fourth Circuit's view that consumers

were in fact unhurt (notwithstanding higher prices²⁸) has legal significance only if actual injury to consumers is a prerequisite to the violation. Such a prerequisite would be wrong and conflict with other circuits. It would be contrary to the statute, which condemns discriminatory pricing where the effect "*may be substantially to lessen competition...*" (emphasis added). It would also be wrong in principle because protecting consumers justifies the condemnation of dangerous conduct even if such conduct is abandoned when it is legally challenged or it turns out to be unsuccessful because the predator miscalculated. A sophisticated actor's express intent to harm consumers and its actual harm to a rival through unambiguously improper conduct creates the "reasonable possibility" of injuring consumers forbidden by the statute and found by the jury in this case.

The Fourth Circuit's requirement of actual effects conflicts with other circuits. For example, the Second Circuit and the Fifth Circuit have ruled under the stricter standards of Sherman Act §2 that the legality of conduct is to be judged at the time it was undertaken in the light of market circumstances as they then were and as they appeared to the actors. *Kelco Disposal, Inc. v. Browning Ferris Industries, Inc.*, 845 F.2d 404, 406 (2d Cir. 1988) (falling market share did not immunize predatory pricing), *aff'd on other grounds*, 492 U.S. 257 (1989); *United States v. American Airlines, Inc.*, 743 F.2d 1114 (5th Cir. 1984), *cert. denied*, 474 U.S. 1001, 1119 (1985) ("it is no defense that the plan proved to be impossible to execute"). And the Eighth Circuit has recognized that "predatory intentions need not be accomplished" although there "must be some reasonable expectation on the part of the alleged predator that it will succeed." *Henry v. Chloride, Inc.*, 809 F.2d 1334, 1345 n.9 (8th Cir. 1987). This conflict deserves resolution.

²⁸ The Fourth Circuit did not deny that the black-and-white discount below regular brands has declined, that the black-and-white segment has contracted, and that all cigarette prices have risen more than costs or inflation. That the generic sector (broadly defined) grew is fully consistent with the reasonableness of B & W's belief that it could benefit from higher prices, that it so benefited, or that its pricing had the desired disciplinary effect.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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September 15, 1992

APPENDIX

**APPENDIX
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**UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT**

LIGGETT GROUP, INCORPORATED,
now named Brooke Group, Limited,

Plaintiff-Appellant,

v.

**BROWN & WILLIAMSON TOBACCO
CORPORATION,**

Defendant-Appellee,

and

GENERIC PRODUCTS CORPORATION,

Defendant.

Nos. 90-1851; 90-1854;
90-49 122

Appeals from the United States District Court
for the Middle District of North Carolina, at Durham.
Frank W. Bullock, Jr., District Judge.
(CA-84-617-D-C)

Argued: February 3, 1992

Decided: May 11, 1992

Before ERVIN, Chief Judge, and HALL and NIEMEYER,
Circuit Judges.

OPINION

NIEMEYER, Circuit Judge:

Liggett Group, Inc., charges Brown & Williamson Tobacco Corporation with pursuing a primary-line predatory pricing scheme in the sale of generic cigarettes during the period 1984-85 in violation of § 2(a) of the Robinson-Patman Act, 15 U.S.C. §13(a). Liggett contends that Brown & Williamson charged below-average-variable-cost prices¹ to force Liggett either to raise the prices of its generic cigarettes or to cease selling them, with the expectation of preserving high profits theretofore earned on sales of branded cigarettes by the industry-wide oligopoly.²

Following a 115-day trial, a jury returned a verdict in favor of Liggett in the amount of \$49.6 million which the district court trebled for a judgment of \$148.8 million. The district court, however, granted Brown & Williamson's motion for judgment notwithstanding the verdict, 748 F. Supp. 344 (M.D.N.C. 1990), and this appeal followed. We now affirm.

I

Cigarettes in the United States have been manufactured in recent years primarily by six companies, Philip Morris, Inc., R.J.

¹ Variable costs are typically considered to be those costs incurred directly in the manufacture of a product, which vary with the number of units manufactured, such as the cost of materials used in the product, labor directly used in its manufacture, and per unit license fees. Variable costs are distinguished from fixed costs that remain constant regardless of the number of units produced. The average variable cost of a product is the sum of all variable costs divided by the number of units produced. See Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697, 700 (1975).

² Whereas a monopoly is the control of a market by one seller, an oligopoly is a market condition that results when there are but a few sellers.

Reynolds Tobacco Corporation, Brown & Williamson, Lorillard, Inc., American Tobacco Company, and Liggett. Philip Morris and R.J. Reynolds, with respectively over 40% and 28% of the market at the time of trial, held the two largest market shares throughout the 1980's. During the relevant period Brown & Williamson's sales never represented more than 12% of the market. Prior to 1980, cigarettes were sold by these companies to distributors at the same price, and when one company increased the price, the others followed. Liggett has characterized this market as "one of the most highly concentrated oligopolies in the United States," which has produced what Liggett's economist has characterized as "supracompetitive profits."³

In 1980 when Liggett's share of the cigarette market in the United States had declined to 2.3%, a level that threatened its viability, it introduced a line of generic cigarettes in black and white packaging. Liggett discounted these generic cigarettes and offered volume rebates to yield an effective price to distributors about 30% lower than that charged for branded cigarettes. By 1984 Liggett's share of the total cigarette market in the United States increased to over 5% and its generics became the fastest growing segment of the market, in which overall sales of cigarettes were declining.

Other manufacturers began responding in 1983. In July of that year, R.J. Reynolds introduced "Century" cigarettes. It sold this brand in cartons of nine packs containing 25 cigarettes each, for the same price as other branded cigarettes sold in cartons of 10 packs containing 20 cigarettes each. These "25s" thus cost consumers 12.5% less than other brands. Brown & Williamson followed suit later that year with "Richland," its own brand of 25s.

Nonetheless, in the 1983-84 period, Brown & Williamson began to observe that it was losing more sales to generic cigarettes, proportionally, than were other manufacturers, and that

³ Profits are supracompetitive when they are unrestrained by competition.

it sustained a "variable margin loss"⁴ of over \$50 million in 1983 alone. It concluded that "unchallenged, [Liggett] could continue its total dominance of this segment..., becoming the third largest company in the U.S. cigarette market." A Brown & Williamson memorandum introduced at trial stated about the Liggett activity:

Stipulating that the industry's interests-other than [Liggett's]-would be far better served had generics never been introduced, they are an immediate and growing threat to all other manufacturers. Competitive counter-actions are essential and inevitable.

After examining each company's capacity and expected response to Liggett's introduction of generic cigarettes, Brown & Williamson determined to enter the generic segment to recapture the sales lost to Liggett. It described the opportunity as follows:

Generics represent B&W's most immediate opportunity to increase volume. This volume can be achieved within current manufacturing capacity, without incremental manpower and without negatively impacting trading profit. No other option offers similar potential to recover lost volume/share with such minimal investment risk. This is true because our goal is to capture existing demand[,] not create new consumer demand.

The same market memorandum revealed a pricing strategy that was intended to produce "a full variable margin" in excess of \$4 per thousand cigarettes. But it went on to state:

⁴ In its internal memoranda Brown & Williamson used "variable margin" to mean the difference between sales revenue and direct manufacturing costs (or variable costs).

B&W is prepared to spend up to net variable margin as a first step response to competitive counter-offers; if required, we are also prepared to go up to, but *not* beyond, full variable margin to gain entry into the generics market.

If [Liggett] goes below full variable margin, Brown & Williamson would not plan to match their offer.

In May 1984, before Brown & Williamson implemented its plan, R.J. Reynolds "repositioned" its brand "Doral," cutting the list price to that charged by Liggett for its generic cigarettes. Brown & Williamson reanalyzed its strategy in light of the Doral move, concluding in the final strategic memorandum,

B&W believes that branded generics will enhance the growth of the economy segment and will draw volume from popular priced brands.

The earlier concern of expanding the economy segment is no longer tenable, given RJR's recent action. It is clear that the economy segment is significant, and growing. Accordingly, recognizing the importance of minimizing increased cannibalization and concomitant share erosion, as well as maintaining trading profit targets, it is imperative that B&W enter this segment.

Shortly thereafter, in July 1984, Brown & Williamson introduced its line of generic cigarettes in black and white packages to compete directly with Liggett's black and white packaged generics. Liggett responded immediately with this lawsuit alleging initially that Brown & Williamson violated the trademark laws. The complaint was amended to add the Robinson-Patman claims that are the subject of this appeal. Liggett also responded by increasing rebates and other incentives to its distributors. During the rest of the summer, the two

manufacturers traded moves and counter-moves four more times in setting prices, offering rebates, and otherwise promoting black and white generic cigarettes. The incentive schemes established when the dust settled in August remained in force until June 1985, when Liggett raised its list price for generics. Brown & Williamson matched the rise in October of that year.

By 1988 all other market participants, except for Lorillard, were selling generics and discounted branded cigarettes, and both R.J. Reynolds and Philip Morris added a black and white generic line. By the time of trial, Lorillard too was in that segment of the market. With the exception of an aborted attempt by Brown & Williamson in December of 1985, no manufacturer raised the price of black and white cigarettes until the summer of 1986. Since then, generic cigarette prices have risen twice a year, in tandem with those of branded cigarettes, reducing the proportional price discount between branded and generic cigarettes from a high of 40% in 1985 to 27% in 1989.

While the United States market for cigarettes has been generally declining, the growth of discounted cigarettes has been dramatic. In 1981 Liggett, which held 97% of the generic sales, sold 2.8 billion cigarettes, representing .4% of the United States cigarette market. By 1988 it sold over 9 billion generic cigarettes. The total sales of generic and discounted cigarettes during the same period increased from 2.8 billion cigarettes to 61.6 billion, representing 11.1% of the entire United States cigarette market. By trial all manufacturers were selling generics and discounted cigarettes, and yearly sales had reached nearly 80 billion cigarettes, representing 15% of the United States cigarette market. The percentage of the market represented strictly by black and white generics peaked in 1985 with 4.7% and was continuing to decline at the time of trial.

No one denies that after Brown & Williamson introduced its black and white generic cigarettes in 1984, the companies fought "tooth and nail" and that the market "got very competitive." Liggett's president confirmed that "competition had substantially increased in the total cigarette market." When all was said and done, Liggett ended up with 3.25% of the market for cigarettes in the United States and Brown & Williamson with 11.36%.

Liggett contends that from June 1984 to the end of 1985, Brown & Williamson sold black and white cigarettes at prices below its "average variable cost," although it acknowledges that Brown & Williamson realized profits in the overall sale of cigarettes in the United States, the agreed upon relevant market. Its Robinson-Patman Act claim focuses on Brown & Williamson's pricing activity for that period, which it contends was predatory, designed to force Liggett to raise its prices for generic cigarettes and thereby to destroy or limit the generic cigarette segment.

After a 115-day trial, the jury returned a verdict in favor of Liggett on its Robinson-Patman Act claim in the amount of \$49.6 million, which the district court trebled under 15 U.S.C. §15 for judgment of \$148.8 million. On Brown & Williamson's motion for judgment notwithstanding the verdict, the district court, after thoroughly analyzing the wide range of issues presented, set aside the judgment and entered judgment in favor of Brown & Williamson.

II

Section 2(a) of the Robinson-Patman Act makes it unlawful for a person engaged in commerce "to discriminate in price between different purchasers of commodities of like grade and quality...where the effect of such discrimination may be substantially to lessen competition...or to injure, destroy, or prevent competition" with the person charging the discriminatory prices. 15 U.S.C. §13(a). The requirement to show that the effect of pricing "may be substantially to lessen competition" may be satisfied by proof of predatory pricing.⁵

Liggett contends that this case is unusual because Brown & Williamson's intent to destroy competition from Liggett's sales of generic cigarettes is so clearly stated in corporate memoranda that, when coupled with evidence that its pricing plan in fact caused

⁵ While predatory pricing generally refers to loss-producing pricing pursued to harm competition and later to realize monopoly profits, as is discussed more fully below, its precise definition for application of the antitrust laws is unsettled.

injury to Liggett, liability is established. It relies on *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967).

While *Utah Pie* is difficult to understand in light of recent economic theory and has been the subject of some criticism over the years, see, e.g., *A. A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396, 1404 (7th Cir. 1989), cert. denied, 494 U.S. 1019 (1990), we are confident that it does not require reversal in this case. In *Utah Pie*, national competitors, using economic muscle from sales in markets other than Salt Lake City, had subsidized below-cost pricing in the Salt Lake City area. The Supreme Court concluded, contrary to the court of appeals, that the plaintiff had adduced sufficient evidence for a jury to infer the requisite possibility of injury to competition, observing that "there was some evidence of predatory intent with respect to each [defendant]" and of a "drastically declining price structure." 386 U.S. at 702-03. The Court did not, however, purport to discuss in detail what evidence was sufficient to infer predatory intent, noting only, "[A]lthough the evidence in this regard against [one defendant who used industrial espionage against the plaintiff] seems obvious, a jury would be free to ascertain a seller's intent from surrounding economic circumstances, which would include persistent unprofitable sales below cost and drastic price cuts themselves discriminatory." *Id.* at 696 n.12. We understand *Utah Pie* to have left for later cases a statement of what more precisely constitutes predatory pricing.

Since *Utah Pie*, the Supreme Court has confirmed that "a firm cannot claim antitrust injury from nonpredatory price competition on the asserted ground that it is 'ruinous.'" *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 338 n.7 (1990). "[N]onpredatory price competition for increased market share, as reflected by prices that are below 'market price' or even below the costs of a firm's rivals, 'is not activity forbidden by the antitrust laws.'" *Id.* at 340 (quoting *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 116 (1986)). However, the line between legitimate competitive pricing, encouraged by the policy of free market competition, and predatory pricing, that is destructive of competition, is murky, and agreement on the distinction has not been reached. See *Cargill*, 479 U.S. at 117 n.12. While pricing "below some appropriate measure of cost" must be shown to establish it as predatory, see *Matsushita Elec.*

Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 585 n.8 (1986), questions remain about the definition of "below-cost" pricing. See *Atlantic Richfield*, 495 U.S. at 341 n.10, *Cargill*, 479 U.S. at 117 & n.12. It is sufficient for this case, however, to observe that predatory pricing must involve, in addition to some level of below-cost pricing that is harmful to competition, the rational expectation of later realizing monopoly profits. The failure to show this additional aspect is fatal. Thus the Court in *Matsushita* held that a conspiracy, which could not hope to recoup its expenses incurred from alleged below-cost pricing and was therefore economically senseless, did not violate the antitrust laws. See *Matsushita*, 475 U.S. at 597-98. The Court explained,

A predatory pricing conspiracy is by nature speculative. Any agreement to price below the competitive level requires the conspirators to forego profits that free competition would offer them. The foregone profits may be considered an investment in the future. For the investment to be rational, the conspirators must have reasonable expectation of recovering, in the form of later monopoly profits, more than the losses suffered....The success of any predatory scheme depends on maintaining monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain.

These observations apply even to predatory pricing by a single firm seeking monopoly power.

Id. at 588-89, 590 (emphasis changed). See also Areeda and Turner, *supra* note 1, at 698 ("[P]redation in any meaningful sense cannot exist unless there is a temporary sacrifice of net revenues in the expectation of greater future gains.").

Turning to this case, Liggett has not advanced a theory that Brown & Williamson could ever obtain or maintain monopoly power for any period of time, much less a period sufficient to reap the harvest of its alleged below-cost pricing, since Brown & Williamson never had more than 12% of the agreed-upon market. Liggett's theory rests on the notion that following the fight in which Brown & Williamson would effectively contain or destroy the generic segment, Brown & Williamson and the other four manufacturers with successful branded cigarettes would, as an oligopoly, reap profits which Liggett predicts would be restored to a "supracompetitive" level.

On the basis of the testimony of its economic expert, William Burnett, Liggett contends that for years the cigarette market in the United States had been an oligopoly. Pointing to historical price increases, it observes that the six members raised prices in lockstep regardless of the amount of increases or even decreases in the cost of tobacco, and without the entry of any significant new competitor in several decades. When Liggett, in 1980, began offering generic cigarettes at prices 30% below those of branded cigarettes, purchasers switched from branded cigarettes to the generic cigarettes offered by Liggett, thereby denying to members of the oligopoly the assertedly supracompetitive prices they had previously enjoyed. Liggett argues that in response to Liggett's success Brown & Williamson developed and implemented a detailed, two-pronged counterattack to contain expansion of or destroy the generic segment. As outlined by Burnett, on the one hand Brown & Williamson removed any disincentive for distributors of generic cigarettes to switch entirely from Liggett to Brown & Williamson by offering their generic cigarettes in a black and white package which consumers would confuse with Liggett's. On the other hand, to lure these distributors away, Brown & Williamson directed discriminatory rebates at Liggett's highest-volume customers, structured to encourage them to pocket the rebates rather than pass them on as price cuts to consumers. Because consumers would not see two competing generic cigarettes or lower prices, consumer demand for generics would not increase and thereby cut further into sales of branded cigarettes. The higher cost of access to its distributors, however, would force Liggett either to raise its overall income by raising list prices to consumers, or to cease selling generic black and white cigarettes entirely.

In either case, asserted Burnett, Brown & Williamson would recoup its losses and make additional gains from the increased sales of its branded cigarettes at the supracompetitive prices established by the historical parallel pricing in the oligopolistic market. According to Burnett, the other members of the oligopoly would not intercede, because they would similarly benefit from decreased "cannibalization" of the sales of their own branded cigarettes.

Shorn of its details, Liggett's theory depicts Brown & Williamson as an oligopolist attempting to discipline another oligopolist for breaking a pattern of parallel pricing, by driving up the offender's costs using finely-tuned predatory pricing of its own. The theory relies upon an expectation that all the other oligopolists would, out of their self-interests, simply stand by and refrain from also selling generics or other low-cost products which would eat into sales of branded cigarettes. Absent such assurance, Brown & Williamson might well drive Liggett out or its prices up, but continue to lose sales of its more profitable branded cigarettes to cannibalistic sales of generics by the other oligopolists. There is no evidence, however, of any conspiratorial agreement among the oligopolists to stay their hands. Liggett's theory therefore amounts to substituting the conscious parallelism of an oligopoly for conspiratorial agreement or actual monopoly power as the reason Brown & Williamson might rationally expect to be able to recoup its investment in disciplining Liggett.

We are aware of no case in which the predicted economic behavior of an oligopoly was relied on to provide a rational means of recoupment of the losses sustained in a predatory pricing scheme, and economic logic as well as actual experience in this case belie such a holding. Oligopolists might indeed all share an interest in letting one among them discipline another for breaking step and might all be aware that all share this interest. One would conclude, however, that this shared interest would not itself be enough to convince a rational oligopolist facing losses of market share to a competitor's price-cut not to match the cut with its own grab for market share. The oligopolist on the sidelines would need to be certain at least that it could trust the discipliner not to expand the low-price segment itself during the fight or after its success. Of course, all the oligopolists on the sidelines would need to be certain that the others were also confident on this point.

Such confidence must be rare, indeed, when the form that the discipline takes is a price-war, which must strike fear in the heart of any oligopolist hoping to protect market share and high prices. More likely, when members of an oligopoly are faced with a competitor's decision to break step, drop prices, and expand market share, they would react competitively.

The facts in this case remove any doubt that no rational oligopolist would be confident that neither Brown & Williamson nor any of the other manufacturers would expand its own sales of low-priced cigarettes at the expense of full-priced branded cigarettes. Brown & Williamson may have intended its disciplinary actions not to affect consumer prices, but outside observers might well not have recognized this plan in the complex and furious rebate war which ensued in the summer of 1984. More importantly, however, Brown & Williamson had already expanded its sales of low-priced cigarettes, when it introduced in 1983 its brand "Richland" at an effective discount of 12.5% to consumers, and R.J. Reynolds, of course, had done the same, first with "Century" and later when it cut the price of its brand "Doral" to the same level as Liggett's generic black and white cigarettes.

Any rational observer would have known that sales of Richland, Century, and Doral would most likely further erode the sales of full-priced branded cigarettes, regardless of Brown & Williamson's success in disciplining Liggett for introducing generic black and white cigarettes. But we need not merely impute rationality to Brown & Williamson. The very memoranda upon which Liggett relies so heavily as evidence of Brown & Williamson's predatory intent not only predict similar actions as occurred, but conclude after the introduction of Doral that "[t]he earlier concern of expanding the economy segment is no longer tenable...."

The perfect vision of hindsight confirms Brown & Williamson's conclusion and our theoretical suspicions. Soon after the events of 1984, most cigarette manufacturers were offering various types of low-priced cigarettes, including generics, and by trial all were vigorously competing with differing devices and approaches. Sales of low-priced cigarettes increased from 2.8 billion cigarettes in 1981 to nearly 80 billion in 1989. Their

proportional share of the overall cigarette market in the United States grew from .4% to 15%.

In the end, Liggett asked the jury to leap from the fact that the cigarette market is a concentrated oligopoly with a history of parallel pricing to the conclusion that the oligopoly would act uncompetitively when one of its members made a competitive move, suggesting some perniciousness in the oligopoly itself. Yet, in the absence of an agreement among the oligopolists, which nobody contends is the fact in this case, membership alone in an oligopoly provides no basis for proof of illegal conduct. Thus no case suggests that mere participation in an oligopolistic market constitutes conduct illegal under the antitrust laws. As the court stated in *E.I. duPont de Nemours & Co. v. Federal Trade Commission*, 729 F.2d 128, 139 (2d Cir. 1984):

The mere existence of an oligopolistic market structure in which a small group of manufacturers engage in consciously parallel pricing of an identical product does not violate the antitrust laws. *Theater Enterprises, Inc. v. Paramount Film Distributing Corp.*, [346 U.S. 537, (1954)]. It represents a condition, not a "method;" indeed it could be consistent with intense competition.

While the parallel but not agreed upon conduct of an oligopoly may be a characteristic of a mature market, as we noted above, such parallelism cannot rationally be assured when an act of competition is undertaken by one participating member. To rely on the characteristics of an oligopoly to assure recoupment of losses from a predatory pricing scheme after one oligopolist has made a competitive move is thus economically irrational. As the Supreme Court pointed out six years ago, "the predator must make a substantial investment with no assurance that it will pay off." For this reason, there is consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful." *Matsushita*, 475 U.S. at 589, (quoting Easterbrook,

Predatory Strategies and Counterstrategies, 48 U. Chi. L. Rev. 263, 268 (1981)).

In short, Brown & Williamson controlled only 12% of the relevant market and could not be assured, when it began its alleged below-cost pricing to suppress competition from Liggett, that the other manufacturers would not also respond competitively. Consequently, the pricing policies undertaken by Brown & Williamson, while perhaps intended to injure Liggett, could not be found to be predatory because they did not provide an economically rational basis "to recoup...losses and to harvest some additional gain." Because we conclude that Liggett is unable to demonstrate that it satisfied an essential element of proving a primary-line pricing scheme in violation of the Robinson-Patman Act, we need not reach the other questions decided by the district court. The judgment of the district court is affirmed.

AFFIRMED

**UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT**

LIGGETT GROUP INC., now named
Brooke Group, Limited,

Plaintiff - Appellant,

v.

BROWN & WILLIAMSON TOBACCO
CORPORATION,

Defendant - Appellee,

and

GENERIC PRODUCTS CORPORATION

Defendant.

June 18, 1992
On Petition for Rehearing with
Suggestion for Rehearing In Banc

The appellant filed a petition for rehearing with suggestion for rehearing in banc. No member of the Court requested a poll on the suggestion for rehearing in banc, and the original judicial panel voted to deny the petition for rehearing.

The Court denies the petition for rehearing with suggestion for rehearing in banc.

Entered at the direction of Judge Niemeyer, with the concurrence of Chief Judge Ervin and Judge Hall.

For the Court,

/s/ Bert M. Montague

Clerk

LIGGETT GROUP, INC., Plaintiff,

v.

**BROWN & WILLIAMSON TOBACCO
CORPORATION, Defendant.**

Civ. No. C-84-617-D.

United States District Court,
M.D. North Carolina,
Durham Division

Aug. 27, 1990

MEMORANDUM OPINION

BULLOCK, District Judge

Liggett Group, Inc., ("Liggett") brought this private antitrust suit to recover treble damages against Brown & Williamson Tobacco Corporation ("B&W") alleging predatory price discrimination in violation of Section 2(a) of the Clayton Act, as amended by the Robinson-Patman Act, 15 U.S.C. § 13(a).¹ Liggett also charged that B&W violated the unfair

¹ The Robinson-Patman Act states in pertinent part:

It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, . . . and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such

competition section of the Lanham Trade-Mark Act, 15 U.S.C. § 1125(a),² as well as various state common law and statutory unfair trade Practices.³

After a lengthy trial,⁴ the jury returned a verdict in favor

discrimination, or with customers of either of them.

² Section 1125(a) states in relevant part:

Any person who shall affix, apply, or annex, or use in connection with any goods or services, or any container or containers for goods, a false designation of origin, or any false description or representation, including words or other symbols tending falsely to describe to represent the same, and shall cause such goods or services to enter into commerce, and any person who shall with knowledge of the falsity of such designation of origin or description or representation cause or procure the same to be transported or used in commerce or deliver the same to any carrier to be transported or used, shall be liable to a civil action by any person doing business in the locality falsely indicated as that of origin or in the region in which said locality is situated, or by any person who believes that he is or is likely to be damaged by the use of any such false description or representation.

³ Liggett's complaint alleges a statutory claim under the North Carolina unfair trade practices statute, N.C. Gen.Stat. § 75-1 *et seq.*, and state common law claims under the North Carolina Common law of trademarks and the North Carolina common law of unfair competition. All these claims stem from B&W's alleged infringement of Liggett's quality seal ("Q-seal") closure by B&W's oval closure seal.

⁴ The jury heard evidence and arguments for 115 days, and considered 2,884 exhibits, 85 deposition excerpts, and testimony from 23 live witnesses. The verdict was returned after nine days of deliberations. The court's instructions to the jury on the antitrust claim were generally consistent with the legal position and theory espoused by Liggett. Some of the same issues and contentions had been considered by the court at summary judgment and/or the directed verdict stage of the trial, and resolved in Liggett's favor. In a complex case such as this, however, development of a complete record is sometimes necessary in order for the

of Liggett on the Robinson-Patman Act claim in the amount of \$49,600,000.00. When trebled pursuant to 15 U.S.C. § 15(a), Liggett's award totals \$148,800,000.00, excluding post-judgment interest and attorneys' fees. The jury found that Brown & Williamson was not liable to Liggett on the trademark unfair competition claims.

B&W has moved for judgment notwithstanding the verdict (JNOV) under Federal Rule of Civil Procedure 50(b) and, alternatively, for a new trial under Federal of Civil Procedure 59 on the antitrust portion of the case.⁵ Liggett has moved for a new trial under Federal Rule of Civil Procedure 59 on its trademark and unfair competition claims. After careful consideration, the court will set aside the antitrust verdict and grant B&W's motion for judgment notwithstanding the verdict. The court will deny B&W's alternative motion for a new trial.⁶ Liggett's motion for

court to have a thorough understanding of the issues and facts in controversy. An ever expanding court docket does not always provide an atmosphere conducive to pre-trial analysis of complex economic and legal issues.

⁵ A different standard applies to a JNOV motion pursuant to Fed. R.Civ.P. 50(b). *see infra* p. 341, than to a motion for a new trial pursuant to Fed.R.Civ.P. 59, *see infra* p. 355.

⁶ A court may in its discretion grant a JNOV motion and deny an alternative motion for a new trial. *See* Fed.R.Civ.P. 50(c)(1); *Stone v. First Wyoming Bank*, 625 F.2d 332, 349-50 (10th Cir. 1980); *Reagin v. Terry*, 675 F.Supp. 297, 304-05 (M.D.N.C. 1986), *aff'd* 829 F.2d 36 (4th Cir.1987). The court's JNOV rulings on competitive injury, causation, and antitrust injury are based upon interpretations of the applicable law. If these interpretations are found to be erroneous and an appellate court applies legal standards more favorable to Liggett, this court does not believe that an examination of the weight of the evidence, the credibility of witnesses and any alleged errors in the admission or rejection of evidence or instructions to the jury would justify granting B&W a new trial. The only remaining significant issue concerns the sufficiency of Liggett's damage evidence. If antitrust injury is proven, courts are lenient in assessing the proof required to support a damage award. *See Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 265-66

a new trial on the trademark and unfair competition claims will be denied.

I. FACTS

The cigarette industry in the United States during the mid-1980's provides the setting for this dispute. Six major manufacturers form this industry.⁷ Phillip Morris and R.J. Reynolds Tobacco Corp. ("RJR") are the industry giants. The other cigarette manufacturers hold substantially smaller market shares. Liggett and B&W compete for wholesale and retail customers across the United States. Both companies sell branded⁸ and generic⁹ cigarettes. At year-end 1985, B&W's total cigarette

S.Ct. 574, 580-81, 90 L.Ed. 652 (1946); *Story Parchment Co. v. Patterson Parchment Paper Co.*, 282 U.S. 555, 563-64, 51 S.Ct. 248, 250-51, 75 L.Ed. 544 (1931). Liggett presented two damage theories and extensive evidence from the testimony of two experts and other witnesses. The court believes there was sufficient evidence to support the jury's damage award.

⁷ The six major cigarette manufacturers are Phillip Morris, Inc., R.J. Reynolds Tobacco Corp., B & W, Lorillard, Inc., American Tobacco Co., and Liggett. A few other domestic and foreign firms have sold cigarettes in the United States during the 1980's, but none has attained any significance in the marketplace.

⁸ The term "branded cigarettes" describes full-price cigarettes targeted to the image-conscious cigarette consumer. Branded cigarettes are advertised heavily and packaged in containers with distinctive designs. Well-known branded cigarettes include Newport, Pall Mall, Kool, Winston, and, of course, Marlboro -- America's most popular branded cigarette by a wide margin.

⁹ The term "generic cigarettes" refers to a catch-all category of cigarettes priced significantly lower than branded cigarettes. Within this category, sometimes called the price-value category, there are different types of generic cigarettes. This dispute centers around one such type -- black and white cigarettes. Black and white cigarettes are sold in plain-looking white packages with black lettering indicating the nature of the product contained within (e.g., "Filter Cigarettes"). These packages look

sales in the United States were about double Liggett's, although Liggett still sold more generic cigarettes than B&W.

The market shares of both companies have declined in recent years. Since 1975 when its market share was nearly seventeen percent (17%), B&W's sales have steadily declined. Liggett has had even less success. Years ago, Liggett was a major force in the cigarette industry, enjoying market shares exceeding twenty per cent (20%). However, Liggett's sales declined precipitously for many years. By 1980, Liggett's market share stood at 2.33%, and the company was close to going out of business. Out of desperation, Liggett became the first major cigarette manufacturer to sell generic cigarettes.¹⁰ Liggett encouraged its customers to buy large quantities of generic cigarettes by offering volume rebates so that the more a customer bought the less the customer paid on a per carton basis.

Generic cigarettes were an unqualified success for Liggett. The segment grew steadily, and by mid-1984 generic sales accounted for 4.1% of the total United States cigarette business with Liggett holding ninety-seven percent (97%) of the segment. The popularity of generic cigarettes attracted other major cigarette manufacturers. In 1983, both RJR and B&W introduced "25's" in response to the success of generic cigarettes.¹¹ In May 1984,

like other generic products on the grocery shelf so that consumers can quickly identify them as lower-priced cigarettes. Another category of generic cigarette is "branded generics." Branded generics are cigarettes in branded packaging but priced in the black and white cigarette range.

¹⁰ Liggett was not the first cigarette company to sell generic cigarettes. Both U.S. Tobacco Co. and G.A. George Georgopulo & Co., smaller cigarette manufacturers with no significant market share, sold generic cigarettes prior to Liggett. However, once Liggett entered the generic category it became the dominant player and was responsible for the segment's initial growth.

¹¹ "Twenty-five's" ("25's") are cigarettes priced and packaged like branded cigarettes but with twenty-five cigarettes contained in each package instead of the standard twenty. RJR introduced Century and B&W introduced Richland as entries in the "25's" category.

RJR also introduced "branded generics."¹² Later that month, B&W announced it would start selling black and white cigarettes positioned to compete directly with Liggett. B&W offered prospective customers volume rebates similar to Liggett's, only higher. Liggett responded by increasing its volume rebates. The rebate war between the companies continued for several more rounds. When the dust settled, B&W's published volume rebates were greater than Liggett's published volume rebates.¹³ This rebate activity took place before B&W began selling generic cigarettes in July 1984, giving rise to this lawsuit in which Liggett alleges that, until the end of 1985, B&W engaged in a predatory pricing campaign designed to "kill" the generic cigarette category.

Today generic cigarettes are a fixture in the cigarette market. Five of the six major cigarette companies have significant entries in the category¹⁴ and growth has been steady. The growth of generic cigarettes has encouraged additional

¹² RJR repositioned Doral, a brand which had previously been unsuccessful competing with other branded cigarettes, by lowering the price to generic levels. Since May 1984, Doral's market share has grown considerably.

¹³ B&W's published volume rebates from mid-1984 to the end of 1985 ranged from sixty to eighty cents per carton depending on the number of cartons a customer brought from the company. B&W's rebate schedule on a per carton basis was as follows: 60¢ rebate for customers who bought 0-499 cases per quarter; 65¢ rebate for customers who bought 500-999 cases per quarter; 70¢ rebate for customers who bought 1,000-1,499 cases per quarter; 75¢ rebate for customers who bought 1,500-7,999 cases per quarter; and 80¢ rebate for customers who bought 8,000 or more cases per quarter.

¹⁴ Lorillard is the only major cigarette manufacturer without a significant presence in the generic cigarette segment.

competition, primarily in the form of couponing and stickering,¹⁵ on branded cigarettes.

II. THE ANTITRUST ISSUES

B & W's JNOV motion may be granted only if, taking all the evidence in the light most favorable to Liggett, there is no substantial evidence to support the jury's verdict. *Evington v. Forbes*, 742 F.2d 834, 835 (4th Cir.1984). Evidence is substantial if it is "of such quality and weight that reasonable and fair-minded men in the exercise of impartial judgment could reasonably return a verdict for the nonmoving party." *Wyatt v. Interstate & Ocean Transp. Co.*, 623 F.2d 888, 891 (4th Cir.1980). However, a mere scintilla of evidence is insufficient to sustain a verdict. *Austin v. Torrington Co.*, 810 F.2d 416, 420 (4th Cir.), cert. denied, 484 U.S. 977, 108 S.Ct. 489, 98 L.Ed.2d 487 (1987). Therefore, in order to warrant JNOV, B & W must show that Liggett has failed to prove an essential element of its claim.

Liggett's antitrust claim is a private, primary-line,¹⁶ non-geographic¹⁷ Robinson-Patman Act suit. Except for the issue of

¹⁵ Coupons are a form of price competition in which money-off vouchers on cigarette cartons and packs are distributed to consumers through newspapers and other mediums. Stickering is a form of price competition in which money-off stickers are attached to cigarette cartons, and sometimes even individual packs. Although the list price of couponed and stickered cigarettes does not change, the amount of money the consumer has to pay at the cash register is lessened by the value of the coupon or sticker.

¹⁶ In Robinson-Patman Act cases, courts distinguish the probable impact of the price discrimination upon competitors of the seller (primary-line injury), the favored and disfavored buyers (secondary-line injury), or the customers of either of them (tertiary-line injury). See 3 E. Kintner & J. Bauer, *Federal Antitrust Law* § 20.9, at 127 (1983).

¹⁷ Non-geographic means that the United States is the relevant market as opposed to any particular city, state, or region.

price discrimination, the jurisdictional elements are undisputed.¹⁸ Despite the connotations of the term "discrimination," there is nothing illegal *per se* about a company discriminating in price. Price discrimination means price difference and nothing more. See *Texaco Inc. v. Hasbrouck*, ___ U.S. ___, 110 S.Ct. 2535, 2544, 110 L.Ed.2d 492 (1990). B & W discriminated in price by charging different net prices¹⁹ to different purchasers via volume rebates in actual black and white cigarette transactions. The other elements²⁰ --competitive injury, causation, and antitrust injury-- have been vigorously contested throughout the entire litigation. The court believes that Liggett's evidence falls short in each of these categories.

A. Competitive Injury

The Robinson-Patman Act prohibits only price discrimination the effect of which "may be substantially to lessen competition." 15 U.S.C. § 13(a). This statutory language has been interpreted to proscribe only that price discrimination which has a reasonable possibility²¹ of injuring competition in the

¹⁸ The parties do not dispute that at least one of the sales of B & W black and white cigarettes was made across a state line; that each pertinent sale of B & W black and white cigarettes was for use and resale in the United States; that the black and white cigarettes sold by B & W were physical items; that the black and white cigarette sales being compared were made by B & W at about the same time; and that the B & W black and white cigarettes involved in the sales being compared were of like grade and quality.

¹⁹ Net price equals list price minus all discounts to the customer.

²⁰ Antitrust injury is a requirement in all antitrust actions for monetary damages brought by private parties. 15 U.S.C. § 15(a). The other elements of Liggett's claim are part of the Robinson-Patman Act. 15 U.S.C. § 13(a).

²¹ A few courts have used a reasonable probability of injuring competition standard instead of reasonable possibility. See, e.g., *Holleb & Co. v. Produce Terminal Cold Storage Co.*, 532 F.2d 29, 35 (7th Cir.1976). This is a distinction of form over substance. See

relevant market. *Falls City Indus., Inc. v. Vanco Beverage, Inc.*, 460 U.S. 428, 434-35, 103 S.Ct. 1282, 1288-89, 75 L.Ed.2d 174 (1983). Prior to trial, the parties stipulated that the relevant market in which to examine competitive injury was the entire United States cigarette market. Therefore, Liggett must prove that B & W's price discrimination in the sale of its black and white cigarettes had a reasonable possibility of injuring competition in the United States cigarette market as a whole.

The competitive injury requirement of the Robinson-Patman Act in the context of this primary-line, non-geographic claim is not fundamentally different from an attempted monopolization claim under Section 2 of the Sherman Act. 15 U.S.C. § 2. Of course, the standards to evaluate competitive injury are different. The Robinson-Patman Act requires a showing of reasonable possibility of injury to competition while the Sherman Act requires a dangerous probability that the attempt to monopolize will be successful. See *Indiana Grocery, Inc. v. Super Value Stores, Inc.*, 864 F.2d 1409, 1413 (7th Cir.1989). However, this difference affects only the quantum of proof needed to satisfy the respective statute's competitive injury requirements and not the type of evidence which furnishes that proof.²² In the present case, the

International Air Indus., Inc. v. American Excelsior Co., 517 F.2d 714, 729 (5th Cir. 1975) ("any difference between the two formulations is trivial"), *cert. denied*, 424 U.S. 943, 96 S.Ct. 1411, 47 L.Ed.2d 349 (1976). The Supreme Court in at least one case has used these standards interchangeably. See *Corn Prods. Refining Co. v. FTC*, 324 U.S. 726, 739, 742, 65 S.Ct. 961, 967-68, 969-70, 89 L.Ed. 1320 (1945).

²² A noted authority explained the parallel competitive injury requirements of the two statutes this way:

Once a price is shown to be below the relevant costs its effect may be substantially to lessen competition, and it is condemned precisely because it has the potential to destroy competition and, if continued, the dangerous probability of doing so. If the price does not violate the relevant predatory pricing standard, it cannot tend to lessen competition or to have the dangerous probability of doing so.

court believes that such evidence must consist of predatory pricing practices indicating a reasonable possibility of injury to competition and consumer welfare rather than evidence merely of injury to a competitor combined with bad intent. Absent some objective economic ability to injure competition conduct cannot be illegal no matter what the intent. See *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588-93, 106 S.Ct. 1348, 1356-59, 89 L.Ed.2d 538 (1986); *Henry v. Chloride, Inc.*, 809 F.2d 1334, 1344-45 (8th Cir.1987).

Liggett fundamentally disagreed with this position at trial and argued numerous times, citing *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685, 87 S.Ct. 1326, 18 L.Ed.2d 406 (1967), that some showing of injury to a competitor combined with bad intent satisfied the Robinson-Patman Act's competitive injury requirement. This court rejects that position in the context of Liggett's atypical primary-line, non-geographic Robinson-Patman Act claim.

The typical primary-line Robinson-Patman Act case is much different from this one, pitting a small business with a limited product-line which competes only in a single geographic region against a large national manufacturer using predatory pricing tactics to displace the local competitor. *Utah Pie* is just such a case. In *Utah Pie*, several national manufacturers of frozen dessert pies challenged a small, family-operated dessert manufacturer which sold pies in the Salt Lake City area. The national manufacturers' strategy was to lower prices below cost on dessert pies in Salt Lake City, 386 U.S. at 696-97 & n. 12, 698, 701, 87 S.Ct. at 1332-33 & n. 12, 1333, 1335, and run the local competitor out of business. The national manufacturers could afford to do this due to profits obtained on the sale of dessert pies in other areas of the country. The local competitor could sell dessert pies only in Salt Lake City and was faced with the bleak prospect of either lowering prices to unprofitable levels or eventually losing its sales to the low-priced pies. It was in this factual setting that the Supreme Court last addressed the requirements of a primary-line Robinson-Patman Act claim.

P. Areeda & H. Hovenkamp, *Antitrust Law* 270, at 618 (Supp. 1989).

Liggett's situation is much different. Liggett, as a national manufacturer of branded and generic cigarettes, is free to compete with B & W in any area of the country over any line of cigarette products and in fact does so. It faces none of the competitive constraints of the local business in *Utah Pie*.²³ In primary-line, non-geographic, predatory pricing cases the Robinson-Patman Act's competitive injury analysis more closely mirrors Section 2 of the Sherman Act than *Utah Pie*. Whether brought under the Sherman Act or the Robinson-Patman Act, predatory pricing is predatory pricing.²⁴ After all, price cutting is the essence of any predatory pricing campaign and, as the Supreme Court has warned, "mistaken inferences in cases such as this one are especially costly, because they chill the very conduct the antitrust laws are designed to protect." *Matsushita*, 475 U.S. at 594, 106 S.Ct. at 1360. Although the Fourth Circuit has not addressed this issue, many other circuits have held that the competitive injury analysis in a predatory pricing case is the same under either the Robinson-Patman Act or Section 2 of the Sherman Act.²⁵

²³ Because the factual differences between geographic and non-geographic primary-line Robinson-Patman Act claims are so striking, the Third Circuit limited *Utah Pie*'s competitive injury analysis to primary-line, geographic price discrimination cases. *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340, 351-52 (3d Cir.1981), cert. denied, 455 U.S. 1017, 102 S.Ct. 1711, 72 L.Ed.2d 134 (1982).

²⁴ See P. Areeda & D. Turner, *Antitrust Law* 720, at 190 (1978) ("The basic substantive issues raised by the Robinson-Patman Act's concern with primary-line injury to competition and by the Sherman Act's concern with predatory pricing are identical.").

²⁵ See *McGahee v. Northern Propane Gas Co.*, 858 F.2d 1487, 1493 n. 9 (11th Cir.1988), cert. denied, ____ U.S. ____, 109 S.Ct. 2110, 104 L.Ed.2d 670 (1989); *Henry*, 809 F.2d at 1345; *D.E. Rogers Assocs., Inc. v. Gardner-Denver Co.*, 718 F.2d 1431, 1439 (6th Cir.1983), cert. denied, 467 U.S. 1242, 104 S.Ct. 3513, 82 L.Ed.2d 822 (1984); *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1041 (9th Cir.1981), cert. denied, 459 U.S. 825, 103 S.Ct. 57, 74 L.Ed.2d 61 (1982); *O. Hommel*, 659 F.2d at 346-47; *Pacific Eng'g & Prod. Co. v. Kerr-McGee Corp.*, 551 F.2d 790, 798 (10th Cir.), cert. denied, 434 U.S. 879, 98 S.Ct. 234, 54 L.Ed.2d 160 (1977);

That this interpretation of the competitive injury requirement has been widely followed is not surprising since it best comports with basic antitrust principles. The antitrust laws' goal is to promote consumer welfare, not to discourage aggressive price competition. Liggett cannot satisfy the competitive injury requirement by showing simply that it was injured by B & W's price discrimination. Injury to competition occurs only if a competitor is able to raise and maintain prices in the relevant market above competitive levels because this is the only situation where consumer welfare is threatened. So, in order to injure competition via price discrimination in the United States cigarette market, B & W must be able to create a real possibility of both driving out rivals by loss-creating price cutting and then holding on to that advantage to recoup losses by raising and maintaining prices at higher than competitive levels. See *Matsushita*, 475 U.S. at 589, 106 S.Ct. at 1357.

With these principles in mind, there are fatal defects in both Liggett's theory and evidence of competitive injury. Liggett's theory of competitive injury was developed by its expert economist, William Burnett. Burnett concluded that B & W's predatory pricing of black and white cigarettes had a reasonable possibility of injuring competition in the entire United States cigarette market. He based his analysis on numerous B & W internal documents and his study of the structure and history of the cigarette industry. Burnett's theory is quite complicated and requires detailed explanation.

Central to Burnett's analysis is that the cigarette market is a highly concentrated oligopoly²⁶ and that predatory pricing schemes make sense in such markets. The starting point for this analysis is Burnett's opinion that all of the manufacturers in the

International Air, 517 F.2d at 720 n. 10. But see *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396, 1404-06 (7th Cir.1989), cert. denied, ___ U.S. ___, 110 S.Ct. 1326, 108 L.Ed.2d 501 (1990); *Monahan's Marine, Inc. v. Boston Whaler, Inc.*, 866 F.2d 525, 528-29 (1st Cir.1989).

²⁶ Oligopoly is the economic term for a market in which few producers are present. There is nothing illegal *per se* about an oligopoly.

cigarette industry, including Liggett, enjoy monopoly profits on the sale of their branded cigarettes. He bases this opinion on six factors: (1) the degree of concentration in the domestic cigarette industry; (2) the long-time industry pattern of list-price uniformity and price leadership--that is, when one manufacturer raises the price of its branded cigarette line the others follow and raise their prices to the same level; (3) the relative price inelasticity²⁷ of cigarette demand; (4) the significant barriers to entry, including large capital costs and the television advertising ban, which prevent new companies from competing with the major cigarette manufacturers; (5) an analysis of the relationship between cigarette prices and costs which concluded that prices have risen in the industry during a period of declining costs; and (6) the degree to which tobacco industry accounting rates of return exceed those of companies in the domestic food and kindred products industry. Burnett thought this industry structure made it possible for the major cigarette manufacturers to tacitly coordinate²⁸ their prices at supracompetitive levels.

According to Burnett, B & W engaged in a campaign of predatory pricing against Liggett's black and white cigarettes to protect its monopoly profits on branded cigarettes. Burnett alleged that B & W had great economic incentive to wage such a predatory campaign. His analysis was based on the following factors. First, consumer demand for cigarettes in the United States market was no longer growing and, due to health concerns, was unlikely to grow in the future. Thus, a cigarette manufacturer could increase its market share only at the expense of a rival competitor by getting existing cigarette consumers to switch their brand loyalty. Second, Liggett was a maverick--that is, Liggett

²⁷ Elasticity means the responsiveness of a dependent variable to changes in a causal factor. Burnett looked at what happened to consumer demand in the cigarette industry when prices rose. He concluded that demand for cigarettes was inelastic because consumer demand did not decrease very much despite steadily rising prices.

²⁸ Burnett does not contend that the major cigarette manufacturers overtly engaged in price-fixing in a smoke-filled room. Instead, he believes the major manufacturers silently agreed that price uniformity was in their best interests and, therefore, priced in lock-step fashion.

was the only major cigarette manufacturer willing to compete for consumers by offering lower prices. Liggett was not worried about its black and white cigarettes cannibalizing its monopoly profits on branded cigarettes because its branded market share was so low. Third, B & W was hurt by Liggett's entry into generic cigarettes more than the other major manufacturers. On a percentage basis, significantly more B & W branded smokers were switching to Liggett generics than were smokers of brands of other manufacturers. As a result, B & W's market share and its alleged monopoly profits were eroding quickly. This erosion gave B & W its incentive to predate.

Burnett testified that B & W came up with an ingenious scheme to kill the generic category and stop losing market share. This alleged scheme is as follows. B & W entered the generic cigarette segment by offering a look-alike black and white package designed to confuse Liggett's existing generic smokers. B & W did not want to fuel consumer demand for generic cigarettes so it focused exclusively on establishing its new business at the wholesale level. B & W captured wholesaler loyalty through significant volume rebates, targeting Liggett's highest volume customers. These rebates made the price of black and white cigarettes to wholesalers well below B & W's average variable cost.²⁹ B & W encouraged the wholesalers to pocket these rebates instead of passing the savings on to consumers to prevent any new demand for black and white cigarettes.

According to Burnett, B & W's plan was a "win-win/lose-lose" strategy of predation since no matter what Liggett did in response B & W's plan would be successful. Because Liggett had

²⁹ Average variable cost equals the sum of all the variable costs divided by output. For a manufacturing firm such as cigarette company, costs are divided into two categories -- fixed and variable. Variable costs fluctuate with a firm's output while fixed costs are independent of output. Variable costs typically include items such as materials, fuel, labor, maintenance, licensing fees, and depreciation occasioned by use. Fixed costs generally include management expenses, overhead, interest on debt, and depreciation accusant by obsolescence. A price below average variable cost causes a manufacturer to lose money on each unit of output of the product.

limited financial resources, if it matched B & W's rebates it would have to cut back on its black and white consumer promotional campaign. This cutback in consumer advertising would slow the growth of the generic category and eventually, without advertising, demand for generic cigarettes would decline. If Liggett refused to offer rebates or offered less lucrative deals, its wholesale customers would abandon it in favor of B & W, preventing Liggett from getting its product to the consumer. In a few years, B & W could control prices in the generic cigarette category. Then it would narrow the price gap between branded and generic cigarettes. Price stimulated consumer demand for black and white cigarettes. By raising generic prices, B & W would decrease the relative savings on black and white cigarettes, thus cutting off consumer demand.

Although predatory pricing schemes are typically very costly due to below-cost pricing, Burnett thought B & W's plan was the exception because of simultaneous recoupment.³⁰ By entering the generic market in the above fashion, according to Burnett, B & W slowed the growth of the generic cigarette segment and thereby slowed the rate at which B & W branded smokers switched to generics. Thus, B & W recovered predatory losses immediately by slowing the loss of sales of its branded cigarettes sold at monopoly prices.

Burnett's theory is buttressed by numerous B & W documents written by top executives. These documents, indicating B & W's anticompetitive intent, are more voluminous and detailed than any other reported case. This evidence not only indicates B & W wanted to injure Liggett, it also details an extensive plan to slow the growth of the generic cigarette segment.³¹

³⁰ Burnett's only theory of recoupment was simultaneous recoupment. He did not contend that B & W's recoupment would come by raising the price of generic cigarettes.

³¹ Issues of corporate ethics and morality, or the lack thereof, are not appropriate subjects for consideration by the court unless they are also violative of the antitrust, trademark, and unfair competition claims alleged.

However, despite Burnett's complicated theory and the extensive documentary evidence, Liggett still has not satisfied the competitive injury requirement of the Robinson-Patman Act with any substantial evidence. As a matter of law, B & W could not have had a reasonable possibility of injuring competition unless at the very least it had the realistic prospect of obtaining market power over the generic segment of the market³² and an economically plausible way to recoup its losses.³³

Market power is "the ability to raise prices above levels that would exist in a perfectly competitive market." *Consul, Ltd. v. Transco Energy Co.*, 805 F.2d 490, 495 (4th Cir. 1986), *cert.*

³² Many circuits have held that the competitive injury requirement of the Robinson-Patman Act cannot be satisfied unless the alleged predator has at least a reasonable prospect of obtaining market power. See *Stitt Spark Plug Co. v. Champion Spark Plug Co.*, 840 F.2d 1253, 1255-56 (5th Cir.), *cert. denied*, 488 U.S. 890, 109 S.Ct. 224, 102 L.Ed.2d 214 (1988); *Henry*, 809 F.2d at 1345; *D.E. Rogers*, 718 F.2d at 1436 (quoting *Richter Concrete Corp v. Hilltop Concrete Corp.* 691 F.2d 818, 823 [6th Cir. 1982]); *O. Hommel*, 659 F.2d at 348; *Janich Bros. Inc. v. American Distilling Co.*, 570 F.2d 848, 856 (9th Cir. 1977), *cert. denied*, 439 U.S. 829, 99 S.Ct. 103, 58 L.Ed.2d 122 (1978); *Pacific Eng'g*, 441 F.2d at 798. A few circuits have been hesitant to apply the market power concept to the Robinson-Patman Act, but this hesitance has always been in the context of geographic price discrimination claims factually distinct from the non-geographic claim alleged here. See *A.A. Poultry Farms*, 881 F.2d at 14044-05; *John B. Hull, Inc. v. Waterbury Petroleum Prods., Inc.*, 588 F.2d 24, 28 (2d Cir. 1978), *cert. denied*, 440 U.S. 960, 99 S.Ct. 1502, 59 L.Ed.2d 773 (1979); *Lloyd A. Fry Roofing Co. v. FTC*, 371 F.2d 277, 284-85 (7th Cir. 1966). Most importantly, the Supreme Court has indicated that "[t]he success of any predatory scheme depends on maintaining monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain." *Matsushita* 475 U.S. at 589, 106 S.Ct. at 1357.

³³ For a predatory pricing scheme to injure competition the predator must be able not only to recover its initial losses, but also harvest some additional gain. *Matsushita*, 475 U.S. at 588-89, 106 S.Ct. at 1356-57. This additional gain is called recoupment, and it is only at the recoupment stage that consumer welfare is injured.

denied, 481 U.S. 1050, 107 S.Ct. 2182, 95 L.Ed.2d 838 (1987). Without the power to control market prices, a firm that raises the price of a product cannot maintain that increase because other firms will offer consumers lower prices, thereby forcing the price raising firm either to lower prices or lose sales. See *Matsushita*, 475 U.S. at 590-91, 106 S.Ct. at 1357-58 ("petitioners must obtain enough market power to set higher than competitive prices, and then must sustain those prices long enough to earn in excess profits what they earlier gave up in below-cost prices"). An avowed predator with no prospect of controlling prices is a paper tiger unable to harm consumer welfare. Burnett's theory illustrates this point. According to Burnett, for B & W's scheme to succeed it had to raise generic cigarette prices above competitive levels; otherwise, it could not narrow the price gap between branded and generic cigarettes. Without a narrowing of this gap there is no incentive for generic consumers to switch back to their old brands, and B & W's alleged scheme necessarily fails.

With at most twelve per cent (12%) of the domestic cigarette market, B & W as a matter of law could not exercise market power unilaterally in either the whole cigarette market or the generic segment. See *Cargill, Inc. v. Monfort of Colorado Inc.*, 479 U.S. 104, 119 n. 15, 107 S.Ct. 484, 494 n. 15, 93 L.Ed.2d 427 (1986). Even Burnett conceded this point, admitting that acting alone B & W could not injure consumer welfare by narrowing the price gap between branded and generic cigarettes. However, Burnett argued B & W was not acting unilaterally due to tacit collusion -- that is, silent price coordination -- among the major manufacturers regarding branded prices. According to Burnett, this tacit collusion effectively gave B & W upwards of ninety-five per cent (95%) of the cigarette market.

Tacit collusion among the major cigarette manufacturers is a dubious theory of market power. In typical cases, market power analysis is straightforward and hinges on whether a company has a large enough market share to control prices in the relevant market. Under this traditional analysis, a company with twelve

per cent (12%) of the market cannot have market power.³⁴ Burnett theorizes, however, that even a relatively small company like B & W can exercise shared market power through tacit collusion with the other major cigarette manufacturers save Liggett. Liggett cites no Robinson-Patman Act or Sherman Act legal precedent which supports this theory of shared market power via tacit collusion. By contrast, the shared market power theory has been rejected several times in the Sherman Act context. See *H.L. Hayden Co. v. Siemens Medical Sys, Inc.*, 879 F.2d 1005, 1018 (2d Cir.1989); *Consolidated Terminal Sys., Inc. v. ITT World Communications, Inc.*, 535 F.Supp. 225, 228-29 (S.D.N.Y. 1982); *In re Kellogg Co.*, 99 F.T.C. 8, 260 (1982). Furthermore, one circuit court considering a Section 2 Sherman Act claim frankly acknowledged that there is "no case support" for the shared monopoly theory. *Harkins Amusement Enters., Inc. v. General Cinema Corp.*, 850 F.2d 477, 490 (9th Cir.1988), cert. denied, 488 U.S. 1019, 109 S.Ct. 817, 102 L.Ed.2d. 806 (1989). Finally, a leading antitrust authority has noted that the scenario for predatory pricing by a firm possessing a small share of the market is "highly speculative" and "presses the potential for tacit price coordination very far." P. Areeda & H. Hovenkamp, *Antitrust Law* 711.2c, at 538-39 (Supp. 1989).

Although there is little legal precedent supporting Burnett's shared market power theory, in rejecting it the court need not rule that this theory is insufficient as a matter of law. The only record evidence supporting such a theory was Burnett's opinion testimony which was contradicted by witnesses from the Liggett boardroom. Liggett's most senior executives, including the president of the company, K.V. Dey unequivocally testified at trial there was not tacit collusion on branded cigarette pricing decisions, that the

³⁴ See, e.g., *United Air Lines, Inc. v. Austin Travel Corp.*, 867 F.2d 737, 742 (2d Cir.1989) (no market power with 10% of the local market and 31% of the national market); *Rutman Wine Co. v. E & J Gallow Winery*, 829 F.2d 729, 736 (9th Cir.1987) (no market power with about 33% of the national market and 25% of the local market); *Pennsylvania Dental Ass'n v. Medical Serv. Ass'n*, 745 F.2d 248, 261 (3d Cir.1984) (no market power with 32-35% of the relevant market), cert. denied, 471 U.S. 1016, 105 S.Ct. 2021, 85 L.Ed.2d 303 (1985).

cigarette industry has never been a collusive oligopoly, and that the industry does not reap excessive profits.

Liggett seeks to explain this obvious problem by arguing that the decision-makers at Liggett are not economists and do not understand economic terms such as oligopoly, tacit collusion, and monopoly profits. This argument was considered at the summary judgment stage since these executives gave basically the same testimony at their depositions. The court allowed the case to go to trial in part because of affidavits from the Liggett executives stating that they were confused by the questions asked by B & W lawyers and did not mean to contradict the testimony of Burnett. However, at trial, despite having consulted extensively with Burnett and having had adequate time to familiarize themselves with concepts such as tacit collusion, oligopoly, and monopoly profits, these Liggett executives again contradicted Burnett's theory. The court realizes that at the JNOV stage all reasonable inferences must be given to Liggett, the non-moving party. However, Burnett's expert opinion testimony on these issues cannot be considered substantial evidence sufficient to survive B & W's JNOV motion in light of unequivocal and contradictory trial testimony from senior executives at Liggett who made the pricing decisions. See *Newman v. Hy-Way Heat Sys., Inc.*, 789 F.2d 269, 270 (4th Cir.1976) (experts may not "speculate in fashions unsupported by, and in this case indeed in contradiction of, the uncontroverted evidence in the case"); *Selle v. Gibbb*, 567 F.Supp. 1173, 1182 (N.D.Ill.1983) ("[T]he law does not permit the oath of credible witnesses, testifying to matters within their knowledge, to be disregarded, particularly where lay persons give testimony contradicting existence of the ultimate fact to be inferred from the opinion of an expert.") *aff'd* 741 F.2d 896 (7th Cir.1984)³⁵

³⁵ *Accord Miller v. FDIC*, 906 F.2d 972, 975 (4th Cir.1990) (plaintiff's contradictory testimony insufficient to create a genuine issue of fact); *Townley v. Norfolk & W. Ry. Co.*, 887 F.2d 498, 501 (4th Cir.1989) (a party may not create an issue of fact by contradicting own testimony); *Barwick v. Celotex Corp.*, 736 F.2d 946, 960 (4th Cir.1984) (a party examined at length on deposition cannot raise an issue of fact simply by submitting an affidavit contradicting the prior testimony).

Even if Burnett's opinion testimony on tacit collusion was uncontradicted, competition could not be injured by B & W unless it could raise generic cigarette prices, thereby narrowing the price gap between branded and generic cigarettes. Yet, even Burnett denied there was tacit collusion in the generic cigarette segment. Instead, his theory relied on the supposed motivations of the other major cigarette manufacturers. Burnett contended that there was an alignment of interest among these companies to protect their branded cigarette profits. Thus, they would not disrupt B & W's attempts to slow the growth of the generic segment. If no such alignment of interest existed and any of the other major cigarette manufacturers were interested in promoting the sale of generic cigarettes, even Burnett admitted that successful predation by B & W would be impossible.

No substantial record evidence supports Burnett's alignment of interest theory. Even before B & W began selling black and white cigarettes, RJR had entered the generic segment by repositioning Doral at generic prices. Burnett conceded that RJR had no anticompetitive intent and that Doral's entry expanded the generic segment. The evidence is uncontroverted that RJR's motive for selling generic cigarettes was to regain its number one position in the cigarette industry from Philip Morris. In order to do this RJR had to sell a lot of generic cigarettes. Furthermore, there is no evidence that any of the other major cigarette companies had an interest in slowing the growth of generic cigarettes. Today, five of the six major manufacturers sell generic cigarettes in one form or another. Most importantly, in late 1985 B & W tried to raise the price of its generic cigarettes. Neither Liggett nor RJR followed with price increases -- exactly what is supposed to happen when a company without market power unilaterally raises its price above competitive level. Had there been an alignment of interest, RJR would have followed B & W's lead.

Not only is there no substantial evidence of market power, the testimony of Liggett's decision-makers that there were no monopoly profits obtained on branded cigarettes and that branded cigarette prices were fair to consumers totally undermines any plausible theory of economic recoupment for B & W. Without some likelihood of recoupment there is no reasonable possibility of injury to competition. Typically, recoupment happens after the

predatory objective has been achieved and the predator has the ability to control prices. As explained earlier, Burnett's theory of simultaneous recoupment departed from this model. However, if there were no monopoly profits from branded cigarettes then B & W could not simultaneously recoup its losses from below-cost pricing.

Even apart from this testimony, there is another problem with Burnett's recoupment analysis. There is no substantial evidence in the record indicating that wholesalers would not promote the sale of generic cigarettes. Burnett's simultaneous recoupment theory depends on wholesalers pocketing B & W's volume rebates instead of promoting generic cigarettes; otherwise, there is no mechanism to slow the growth of the segment. Yet it makes no sense for wholesalers to pocket all of these rebates. Unlike branded cigarettes, there were no guarantees for wholesalers when they bought B & W's generic cigarettes. If the wholesalers did not sell all the generic cigarettes they bought, they were stuck with the product. B & W's volume rebates were lucrative to them only if they could sell their generic cigarette allotment; otherwise, they lost money. Therefore, there was no alignment of interest between B & W and the wholesalers with respect to generic cigarettes. To the extent that wholesalers wanted to sell generics to consumers, and the only record evidence at trial indicates that they did, B & W not slow the growth of the category and consumer welfare could not be injured.

Similarly, documentary evidence alone is not substantial evidence sufficient to satisfy the competitive injury requirement of the Robinson-Patman Act absent some showing of market power and the possibility of recoupment. *See Henry*, 809 F.2d at 1345. A company with anticompetitive intent cannot injure consumers unless it has at least a reasonable possibility of obtaining market power and recouping its losses. B & W could not achieve either of these objectives and, therefore, it does not matter what the documents say concerning its hopes and plans.

Finally, Liggett did not provide any substantial evidence of actual injury to competition via market analysis. Obviously, without even the realistic prospect of obtaining market power it is impossible for a firm to actually injure competition since prices cannot be increased above competitive levels. Furthermore, even

Liggett admits that the generic cigarette segment has grown. Five of the six major cigarette companies have significant entries in the generic category, and growth has increased from about four per cent (4%) when Liggett was alone in the segment to fifteen per cent (15%). The success of generic cigarettes has even encouraged some price competition on branded cigarettes. This court is aware of no Robinson-Patman Act verdict upheld solely on market analysis grounds. Liggett's market analysis evidence is not compelling enough for this court become the first.³⁶

B. Causation

The Robinson-Patman Act is aimed only at price discrimination. Liggett must prove that the reasonable possibility of injury to competition was "the effect of" price discrimination, 15 U.S.C. § 13(a), in order to establish "the necessary causal

³⁶ Much of Liggett's market analysis focus on the steady decline of the market share of black and white cigarettes. This decline has not injured consumers because of the steady growth of branded generic cigarettes sold at the same price as black and white cigarettes. Overall, the generic segment has grown with consumers preferring branded generic cigarettes to black and white cigarettes. The rest of Liggett's market analysis is equally unconvincing. Liggett contends that B & W caused the price differential between branded and generic cigarettes to decrease. Yet, the percentage price differential has remained about thirty per cent (30%), and B & W quickly retracted the only generic cigarette price increase that it initiated because the competition did not follow. Liggett also alleges that B & W's pricing forced it to reduce its advertising, thereby slowing the segment. Still, the generic cigarette category continued to grow, fueled in part by RJR's aggressive promotion of Doral. Finally, Liggett argues that the military market provides empirical evidence of actual injury to consumers. The generic segment now accounts for over thirty per cent (30%) of the military market, as compared to approximately fifteen per cent (15%) of the civilian market. However, the age, income, and image differences in the military and the civilian sectors make such inferences suspect; the market for generic cigarettes had grown in both sectors; and without any realistic prospect of obtaining market power B & W's conduct cannot be the cause of the different market shares in the two sectors.

relationship between the difference in prices and the alleged competitive injury." *Borden Co. FTC*, 381 F.2d 175, 180 (5th Cir.1967).³⁷

In a typical primary-line Robinson-Patman Act case, the injury alleged is the result of geographic price discrimination. As the Supreme Court has explained, the Clayton Act, as amended by the Robinson-Patman Act, "was born of a desire by Congress to curb the use by financially powerful corporations of localized price-cutting tactics which had gravely impaired the competitive position of other sellers." *FTC v. Anheuser-Busch, Inc.*, 363 U.S. 536, 543, 80 S.Ct. 1267, 1271, 4 L.Ed.2d 1385 (1960) (footnote omitted).³⁸ Proof of causation is straightforward when the price discrimination is geographic. In these cases, a national firm can supplant local competitors confined to a specific geographic market by charging below-cost prices in that market. The local competitor is necessarily limited to competing for customers who can buy at the below-cost price offered by the national company. The national firm can subsidize its losses in the local market through profits from sales in other geographic areas. Therefore, since the national firm can remain profitable while the local competitor cannot, the difference between the national firm's below-cost prices and its profitable prices has a reasonable possibility of injuring competition. However, Liggett's primary-line, non-geographic claim differs from this scenario, and the geographic causation rationale discussed above has no persuasive force. Both B & W and Liggett competed for generic sales throughout the United States, and Liggett competed in all the markets in which B & W offered the discriminatory prices.

³⁷ *Accord Stitt Spark Plug*, 840 F.2d at 1257; *Black Gold, Ltd v. Rockwool Indus., Inc.*, 729 F.2d 676, 680 (10th Cir.), *Cert. denied*, 469 U.S. 854, 105 S.Ct. 178, 83 L.Ed.2d 113 (1984); *William Inglis*, 668 F.2d at 1040; *Marty's Floor Covering Co. v. GAF Corp.*, 604 F.2d 266, 270 (4th Cir. 1979), *cert. denied*, 444 U.S. 1017, 100 S.Ct. 670 L.Ed.2d 647 (1980).

³⁸ *Accord Stehpen Jay Photography, Ltd. v. Olan Mills, Inc.*, 903 F.2d 988, 991 & n. 5 (4th Cir.1990); *O. Hommel*, 659 F.2d at 350; *Marty's Floor Covering*, 604 F.2d at 270; *International Air*, 517 F.2d at 720-21.

Because this claim is non-geographic, Liggett has not proven causation by any substantial evidence. The Robinson-Patman Act does not proscribe low prices. B & W's net prices were generally lower than Liggett's at every volume level. Yet, if there was any reasonable possibility of injury to competition from B & W's conduct it came from the low price that B & W offered to its customers and not from the fact that these low prices varied depending on volume. See *O. Hommel*, 659 F.2d at 350-51 (when price discrimination occurs only in the same geographic market in which the predator and the target compete "[s]elective price-cutting cannot possibly be more harmful to small competitors than a general price reduction to the same level") (quoting Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv.L.Rev. 697, 725-26 [1975]).³⁹

Even if B & W's low prices created a reasonable possibility of injuring competition by displacing Liggett and making it possible for B & W to raise generic cigarette prices, the fact that those prices varied gave B & W no advantage over Liggett. Liggett was free to compete for sales to B & W's low volume generic customers, as well as those customers getting the best deals from B & W. Liggett was not excluded from any markets. As a result, Liggett was not disadvantaged any more by B & W's volume rebates than it would have been by one uniform low price. Liggett's complaint is that B & W was selling generic cigarettes for a lower price than it could at all volume levels. Consequently, Liggett has not met its burden of causation because low prices, not price discrimination, provide the only possible linkage to competitive injury.

Liggett disagrees. It contends that the price discrimination was a central component of B & W's predatory plan enabling B & W to make its scheme cost effective and inducing wholesalers to buy generic cigarettes exclusively from B & W. The court will consider these arguments in turn.

Liggett contends that price discrimination made B & W's plan feasible by making it less costly than if B & W offered only

³⁹ *Accord Official Publications, Inc. v. Kale News, Co.*, 884 F.2d 664, 667-68 (2d Cir.1989); *Borden*, 381 F.2d at 180.

one low price. It cites several documents indicating that B & W wanted to "put the money where the volume was." There are no primary-line, non-geographic cases, that this court is aware of, in which cost efficiency satisfied the Robinson-Patman Act's causation requirement. Such an argument if accepted would read any meaningful causation requirement out of the act. As opposed to one low price set at B & W's high volume rate, volume rebates certainly saved the company money. However, the same is true of any price discrimination by any firm since price discrimination by definition requires a higher and a lower price. Furthermore, although it may have been more cost efficient for B & W, price discrimination also meant that it would cost less for Liggett to match B & W's prices. Since Liggett and B & W had access to the same customers and markets, B & W could not inflict greater injury on Liggett by charging a lower uniform price. If Liggett was not injured more by the price discrimination then neither was competition, since Burnett's competitive injury theory hinges on B & W replacing Liggett as the generic price leader.

Liggett also argues that B & W's discriminatory rebates encouraged wholesalers to buy generic cigarettes exclusively from B & W. According to Liggett, the volume rebates acts as a magnet enticing customers to buy more B & W generic cigarettes to get to the next rebate level; because higher volume purchases entitled customers to higher discounts, customers opting to allocate a portion of their generic cigarette purchases to Liggett would in effect be penalized; to avoid this penalty customers would buy exclusively from B & W; the more exclusive relationships B & W could cement with former Liggett wholesale customers the faster B & W could displace Liggett and increase generic prices.

Again, Liggett cites no primary-line, non-geographic cases which support its analysis that encouraging exclusivity satisfies the Robinson-Patman Act's causation requirement. Volume discounts do not hurt Liggett, and hence competition, more than any other incentive since both companies compete for the same customers and the same markets. Liggett could respond to B & W's volume rebates by allocating the majority of its own incentives to its high-volume customers, a practice it had followed even before B & W's entry. Furthermore, the only advantage to a wholesaler from getting into B & W's highest volume category is receiving the lowest volume levels, B & W's net prices were below Liggett's,

obviously an incentive for a customer to buy only from the manufacturer offering the lowest price on the same product. Therefore, the magnet enticing customers to buy generic cigarettes exclusively from B & W was that B & W's net prices were below Liggett's at every volume level and not that B & W's competitive offer to customers took the form of volume rebates.

C. Antitrust Injury

In a private treble damage action brought under Section 4 of the Clayton Act,⁴⁰ there is an additional causation requirement-antitrust injury. Not only must Liggett prove that B & W's price discrimination had a reasonable possibility of injuring competition, Liggett also must prove that B & W's price discrimination caused its complained-of damages.

A private plaintiff like Liggett may not recover damages simply by showing "injury causally linked to an illegal presence in the market." *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489, 97 S.Ct. 690, 697, 50 L.Ed.2d 701 (1977). Instead, Liggett must prove it was injured by conduct violating the Robinson-Patman Act. See 15 U.S.C. § 15(a). That is, Liggett must prove the existence of "antitrust injury, which is to say injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful." *Allegheny Pepsi-Cola Bottling Co. v. Mid-Atlantic Coca-Cola Bottling Co.*, 690 F.2d 411, 414 (4th Cir.1982) (quoting *Brunswick*, c 429 U.S. at 489, 97 S.Ct. at 697-98). Therefore, Liggett cannot recover damages unless it is "able to show a casual connection between the price discrimination in violation of the Act and the injury suffered." *Perkins v. Standard Oil Co.*, 395 U.S. 642, 648, 89 S.Ct. 1871, 1874, 23 L.Ed.2d 599 (1969).

Subsequent to the completion of this trial, the Supreme Court decided a case clarifying the requirements of antitrust injury. The Supreme Court held:

⁴⁰ Section 4 the Clayton Act is a remedial provision that makes treble damages available to "any person who shall be injured in his business or property by reason of any thing forbidden in the antitrust laws." 15 U.S.C. §15(a).

Antitrust injury does not arise for purposes of § 4 of the Clayton Act until a private party is adversely affected by an *anticompetitive* aspect of the defendant's conduct; in the context of pricing practices, only predatory pricing has the requisite anticompetitive effect. Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition. Hence, they cannot give rise to antitrust injury.

Atlantic Richfield Co., v. USA Petroleum Co., ___ U.S. ___, 110 S.Ct. 1884, 1892, 109 L.Ed.2d 333 (1990) (citations and footnotes omitted). In the context of the present case, *Atlantic Richfield* makes clear that only evidence of predatory pricing is sufficient to prove antitrust injury. Neither incriminating documentary evidence nor an allegedly distorted market proves antitrust injury unless accompanied by proof of predatory pricing. *Id.* 110 S. Ct. at 1891 n. 7 ("a firm cannot claim antitrust injury from non predatory price competition on the asserted ground that it is ruinous").

Liggett, of course, disagrees with this interpretation of *Atlantic Richfield*, arguing that the Supreme Court's antitrust injury analysis applies only to vertical maximum resale price-fixing cases and that the decision illustrates only that Sherman Act principles are different from Robinson-Patman Act principles. It cites as proof the fact that the Supreme Court in *Atlantic Richfield* did not dismiss the Robinson-Patman Act claim since it was "misconduct not relevant here." 110 S.Ct. at 1887. In *Atlantic Richfield*, plaintiff sued defendant under various legal theories including the Sherman Act, the Robinson-Patman Act, and state law unfair competition statutes. Defendant moved for summary judgment on the Section 1 Sherman Act claim and the district court granted the motion. On appeal, both the Ninth Circuit and the Supreme Court considered only the issue of whether dismissing plaintiff's Section 1 Sherman Act claim was proper. The Robinson-Patman Act claim was not relevant to the Supreme Court's decision because that claim was not before it. This language of the Supreme Court cannot be construed to mean that antitrust injury principles under the Robinson-Patman Act are fundamentally different from those under the Sherman Act.

Liggett's interpretation of *Atlantic Richfield* is legally insupportable for several reasons. First, Liggett alleges a primary-line, non-geographic Robinson-Patman Act claim analytically similar to a Section 2 Sherman Act attempted monopolization claim. The goal of both statutes is to maximize competition. Second, Liggett's interpretation is anticompetitive since it protects Liggett from non-predatory price competition by B&W despite the fact that such activity cannot injure competition. In *Atlantic Richfield*, the Supreme Court reiterated that 'cutting prices in order to increase business often is the very essence of competition,' *id.* at 1891 (quoting *Matsushita*, 475 U.S. at 594, 106 S.Ct. at 1360), and Liggett has provided no theoretical justification for distinguishing between straight price cuts and volume rebates. Also, the Supreme Court has held on numerous occasions that the Robinson-Patman Act should be conformed if at all possible to the standards governing the other antitrust laws. See *Great Atl. & Pac. Tea Co. v. FTC*, 440 U.S. 69, 80, 99 S.Ct. 925, 933, 59 L.Ed.2d 153 (1979); *United States v. United States Gypsum Co.*, 438 U.S. 422, 548-59, 98 S.Ct. 2864, 2884-85, 57 L.Ed.2d 854 (1978); *Automatic Canteen Co. v. FTC*, 346 U.S. 61, 63 73 S.Ct. 1017, 1019, 97 L.Ed. 1454 (1953). Third, Section 4 of the Clayton Act, 15 U.S.C. § 15(a), provides the antitrust injury standard for both the Sherman Act and the Robinson-Patman Act. It would be odd indeed to interpret the same language of Section 4 one way under the Sherman Act and another under the Robinson-Patman Act. Fourth, and most importantly, Liggett's interpretation requires this court to ignore the plain language of *Atlantic Richfield* in which the Supreme Court clearly stated that non-predatory pricing behavior cannot give rise to antitrust injury "regardless of the type of antitrust claim involved." 110 S. Ct. at 1892.

Liggett also argues that *Atlantic Richfield* does not apply to Robinson-Patman Act claims because it is price discrimination rather than predatory prices which must cause the antitrust injury. Liggett's position is correct as far as it goes. In Robinson-Patman Act cases the price discrimination must be linked with the antitrust injury. However, this does not mean that predatory pricing is not relevant. For that position to have merit there would have to be some anticompetitive aspect of price discrimination other than the fact that one or all of the prices charged were predatory. Yet, the only anticompetitive aspect to B&W's volume rebates is that they

were allegedly below cost. Burnett's theory is that B&W's below-cost, volume rebates were designed to drive Liggett out of the generic cigarette segment. The below-cost aspect of these rebates was crucial since this forced Liggett to either lose money on the sale of generic cigarettes or lose customers to B&W. For these reasons this court is convinced that in a primary-line, non-geographic price discrimination case predatory pricing is the only type of evidence which satisfies the antitrust injury requirement.

The court must examine whether Liggett has presented any substantial evidence of antitrust injury. The Supreme Court has stated that "predatory pricing may be defined as pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run." *Cargill*, 479 U.S. at 117, 107 S.Ct. at 493. But the Court has never defined what "cost" is relevant. *Id.* at 117 n. 12, 107 S.Ct. at 493 n.. Given this Supreme Court guidance, most circuits presume that pricing below reasonably anticipated marginal cost is predatory.⁴¹ Because marginal costs cannot be determined easily from conventional accounting methods, average variable cost is used as a surrogate. Most cases of predatory pricing focus on average variable cost evidence, and this one is no different.⁴²

Liggett's predatory pricing evidence consisted of expert testimony that B&W priced its generic cigarettes below average variable cost. B&W countered with its chief financial officer who admitted that B&W lost money on the sale of generic cigarettes but stated prices were never below average variable cost. He explained that most companies lose money when they introduce a new product and that there was nothing exceptional about that.

⁴¹ See, e.g., *Northeastern Tel. Co. v. AT&T Co.*, 651 F.2d 76, 88 (2d Cir.1981) (citations collected therein), *cert. denied*, 455 U.S. 943, 102 S.Ct. 1438, 71 L.Ed.2d 654 (1982).

⁴² This court used average variable cost because Liggett's evidence of predatory pricing centered on this measure; average variable cost is a conservative measure unlikely to penalize the competitive pricing activities of a more efficient competitor; and many circuits use some variant of the average variable cost test to isolate predatory pricing.

Furthermore, he stressed that B&W's overall line of cigarettes--generic plus branded--was very profitable.

In order to evaluate Liggett's predatory pricing evidence, this debate need not be resolved. The court believes that Liggett's predatory pricing evidence must show that B&W lost money in the relevant market stipulated to by the parties prior to trial--the market for all cigarettes in the United States. Liggett has not and cannot do this. The evidence is uncontroverted that B&W made money on its overall cigarettes sales--branded and generic--during the alleged predatory period.

The parties have stipulated that the relevant market is the entire cigarette market in the United States. Upon close examination, this court believes that there is no substantial economic evidence that generic cigarettes are sufficiently distinct from branded cigarettes alone.⁴³ Markets are determined by the substitutability of goods, and market definitions turn on these goods' cross-elasticity of demand and supply. Cross-elasticity of demand is the extent to which products are "reasonably interchangeable by consumers for the same purposes." *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395, 76 S.Ct. 994, 1007, 100 L.Ed. 1264 (1956). Cross-elasticity of supply is "the capability of other production facilities to be converted to produced a substitutable product." *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 794 F.2d 210, 218 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1033, 107 S.Ct. 880, 93

⁴³ Since Liggett and B&W are full-line competitors who compete for market share across all cigarette product lines, this court instructed the jury that they could consider Liggett's below-cost pricing evidence only if they determined that generic cigarettes formed a well-defined submarket based on the practical indicia test of *Brown Shoe Co. v. United States*, 370 U.S. 294, 324, 82 S.Ct. 1502, 1524, 8 L.Ed.2d 510 (1962). The court used this concept to aid the jury in determining whether generic cigarettes were sufficiently distinct from branded cigarettes to justify applying the average variable cost test to generic cigarettes, and not as a means of deciding the appropriate market in which to evaluate competitive injury. If there are no significant economic differences between the two products there is no reason to analyze their price-cost relationship separately.

L.Ed.2d 834 (1987). There is obviously high cross-elasticity of demand between branded and generic cigarettes. In fact, Liggett's theory hinges on consumers substituting generic for branded cigarettes because the alleged reason for predating was that B&W branded smokers were switching to Liggett's generic cigarettes. There is also high cross-elasticity of supply between branded and generic cigarettes because the same machines that make branded cigarettes can easily produce generic cigarettes.

Because there is no question that generic and branded cigarettes compete with each other for the favor of consumers, there is no economic justification for analyzing one separately from the other. Where there is nothing economically distinct about a particular product line, the average variable cost test should not be applied to it. Dr. Philip Areeda, one of the fathers of that test, explains that where the predator and the target sell the same line of products the average variable cost test should be applied to an alleged predator's entire product line instead of to a particular product because "rivals generally can hardly be ruined so long as prices for the product line as a whole are compensatory." P. Areeda & H. Hovenkamp, *Antitrust Law* 1715.1a, at 592 (Supp. 1989). Numerous courts, in cases like this one where the parties are full product line competitors, have refused to apply the average variable cost test to a single product line because there could be no competitive injury in the relevant market even if that product line was priced below cost.⁴⁴

⁴⁴ See *Morgan v. Ponder*, 892 F.2d 1355, 1361-62 (8th Cir. 1989) (court refuses to apply a price-cost test solely to legal advertising as opposed to all commercial advertising); *Stitt Spark Plug*, 840 F.2d at 1256-57 (a relevant predatory pricing analysis must include defendant's entire line of spark plugs and not just its original equipment line); *Directory Sales Management Corp. v. Ohio Bell Tel. Co.*, 833 F.2d 606, 614 (6th Cir. 1987) (although a telephone company gave away free first listings in its telephone book, they engaged in predatory pricing only if their "overall charges for advertising space in their yellow pages are priced below cost"); *Lomar Wholesale Grocery, Inc. v. Dieter's Gourmet Foods, Inc.*, 824 F.2d 582, 597-98 (8th Cir. 1987), *cert. denied*, 484 U.S. 1010, 108 S.Ct. 707, 98 L.Ed.2d 658 (1988) (court refused to apply below-cost pricing test to only four of the 180 common items that competing specialty food stores sold); *Bayou Bottling, Inc. v. Dr. Pepper*

During the alleged predatory period, Liggett and B&W were both profitable, full product line competitors with access to the same customers and markets. Due to these facts, applying the average variable cost test solely to B&W's generic cigarettes would be inappropriate. An examination of price-cost relationships should be made only in reference to the dangers posed by predatory pricing. *Henry*, 809 F.2d at 1344 ("the issue of 'predatory intent' should focus on what the defendant did and whether it could lead to the evil feared"). Under Liggett's theory, the danger posed by B&W's predatory pricing was that B&W would obtain control of the generic segment, raise prices, and thereby kill-off the only low-price alternative to branded cigarettes to the disadvantage of consumers. Even assuming that this danger was real, consumer welfare could not be injured if Liggett responded by switching emphasis to its line of branded cigarettes and decreasing their price, thus charging consumers a fair price instead of a monopolistic one. This would prevent injury to both Liggett and the consumer. Liggett's market share would increase to offset its lost monopoly profits and consumers would still have a low-price cigarette alternative. Furthermore, B&W could not recoup if Liggett decreased branded prices because cost-conscious consumers would switch to the low-price Liggett brands instead of other branded cigarettes priced at monopoly rates. If the average variable cost test is applied solely to generic cigarettes and antitrust injury is inferred from this below-cost pricing, then Liggett is unjustly rewarded for failing to compete on price with its branded cigarettes. Under this scenario, Liggett's antitrust injury would come from its unwillingness to charge a competitive price for its branded cigarettes and not from B&W's price discrimination. Since Liggett has failed to introduce substantial evidence of predatory pricing to meet the antitrust injury

Co., 725 F.2d 300, 305 (5th Cir.), *cert. denied*, 469 U.S. 833, 105 S.Ct. 123, 83 L.Ed.2d 65 (1984) (where both parties are full-line competitors, 32-ounce bottles not a relevant product to apply average variable cost test to); *Janich Bros.*, 570 F.2d at 856 (half gallon containers of gin and vodka are not relevant products for predatory pricing analysis); *Sewell Plastics, Inc. v. Coca-Cola Co.*, 720 F.Supp. 1196, 1228 (W.D.N.C. 1988) (three-liter bottles not a relevant product for predatory pricing analysis).

requirement, this provides another ground for granting B&W's JNOV motion.

III. THE TRADEMARK ISSUES

Liggett has made a motion for a new trial pursuant to Rule 59, Fed.R.Civ.P., on the trademark and unfair competition claims arising from B&W's alleged infringement of Liggett's quality seal trademark. Liggett contends that the court should order a new trial on these issues because (1) the jury verdict was clearly against the weight of the evidence, (2) B&W repeatedly relied upon prejudicial, inadmissible, and improper evidence which obtained the jury process, and (3) Liggett was precluded from using evidence which could have countered B&W's prejudicial and misleading arguments. The court finds these contentions to be without merit, and Liggett's motion will be denied.

A motion for a new trial is governed by a different standard than a JNOV motion. *Gill v. Rollins Protective Servs. Co.*, 773 F.2d 592, 594 (4th Cir.1985), *modified on other grounds*, 788 F.2d 1042 (4th Cir.1986). Recently the Fourth Circuit has reiterated the trial court's duty in ruling on a Rule 59 motion for a new trial. In *Poynter by Poynter v. Ratcliff*, 784 F.2d 219, 223 (4th Cir.1989), the court explained that:

Under Rule 59 of the Federal Rules of Civil Procedure, a trial judge may weigh the evidence and consider the credibility of the witnesses and, if he finds the verdict is against the clear weight of the evidence, is based on false evidence or will result in a miscarriage of justice, he must set aside the verdict, even if supported by substantial evidence, and grant a new trial.

See also Wyatt, 623 F.2d 888, 891-92; *Williams v. Nichols*, 966 F.2d 389, 392 (4th Cir.1992). A new trial may also be granted if the court believes it has erred in the admission or rejection of evidence, or improperly instructed the jury. *Montgomery Ward & Co. v. Duncan*, 311 U.S. 243, 251, 61 S.Ct. 189, 194, 85 L.Ed. 147 (1940).

To establish trademark infringement a plaintiff must prove that there is a "likelihood of confusion" between its mark and the defendant's mark. *Pizzeria Uno Corp. v. Temple*, 747 F.2d 1522, 1527 (4th Cir.1984). Both parties presented evidence from which a reasonable jury could have found in favor of that party on the trademark and unfair competition issues. The jury ruled for B&W. From the evidence introduced on the seven likelihood of confusion factors outlined in *Pizzeria Uno*,⁴⁵ the verdict cannot be considered contrary to the clear weight of the evidence.

The cornerstone of Liggett's position is its contention that B&W's stipulation of the validity of Liggett's quality seal trademark precluded any evidence or argument by B&W that consumers were not aware of the quality seal. Liggett couples this argument with the contention that B&W's repeated references to the results of Liggett's Conway Milken Report, a telephone survey of consumers conducted by Liggett, as proof of lack of consumer recognition of the quality seal, were improper and contrary to the court's *in limine* ruling.

Liggett's contention that the stipulation of validity of the quality seal trademark precluded evidence and argument by B&W that most consumers were not aware of the mark is contrary to the position taken by Liggett's counsel at trial. Liggett's counsel conceded on the record at the charge conference that the strength of the mark was a question for the jury, that B&W could argue that it was not recognized, and that Liggett could argue that it was recognized. Evidence of the extent of consumer awareness of a mark obviously helps a jury determine the scope of protection to be afforded the mark. However, the court clearly instructed the jury that Liggett had valid federal trademark registrations for the quality seal and that the jury must accept the quality seal as a valid trademark.

⁴⁵ The seven factors are: (1) the strength or distinctiveness of the mark; (2) the similarity of the two marks; (3) the similarity of the goods/services identified by the marks; (4) the similarity of the facilities the two parties use in their businesses; (5) the similarity of the advertising used by the two parties; (6) the defendant's intent; (7) actual confusion.

Furthermore, Liggett's argument that the stipulation of validity precludes evidence that consumers were not aware of the mark is simply not the law. See *Miss World (U.K.) Ltd. v. Mrs. America Pageants*, 856 F.2d 1445, 1449 (9th Cir.1988) ("[A]n incontestable status does not alone establish a strong mark."); *Oreck Corp. v. U.S. Floor Sys., Inc.*, 803 F.2d 166, 171 (5th Cir. 1986) (incontestable status does not preclude defendant from arguing mark is weak and not infringed; "Incontestable status does not make a weak mark strong."), *cert. denied*, 481 U.S. 1069, 107 S.Ct. 2462, 95 L.Ed.2d 781 (1987); see also *Munters Corp. v. Matsui America, Inc.*, 730 F.Supp. 790, 795-96 (N.D. Ill. 1989), *aff'd* 909 F.2d 250 (7th Cir. 1990); *Cullman Ventures, Inc. v. Columbian Art Works, Inc.*, 717 F.Supp. 96, 121 (S.D.N.Y. 1989); 2 J. McCarthy, *Trademarks and Unfair Competition* § 32:44D (2d ed. 1984 & Supp. 1989).

Liggett's emphasis on B&W's questions to witnesses and arguments about Liggett's Conway Milliken study is also misplaced. The court explained on numerous occasions during the trial that Liggett's extensive testimony and evidence concerning the promotion of its quality seal opened the door to cross-examination and evidence of the effectiveness of that promotion. The court then allowed Liggett to present additional evidence about what the study was designed to determine, how it was conducted, and the significance of the results. Furthermore, Liggett's counsel had ample opportunity in closing arguments to counter any arguments by B&W's counsel concerning the significance of the Conway Milliken Report.⁴⁶

⁴⁶ Liggett also contends that B&W improperly took advantage of the court's pre-trial rulings which prevented Liggett from calling consumers who had confused B&W's black and gold lion closure seal, a seal which was not the basis of Liggett's claim in this case, with the Liggett quality seal trademark. Liggett further contends that it was tricked or prevented from calling Saul Lefkowitz, a former chairman of the United States Trademark Trial and Appeal Board, who would have testified that registration of the quality seal was proper, a fact B&W conceded. Other proposed testimony by Mr. Lefkowitz sought to instruct the jury on the law, a matter within the province of court. The court is satisfied that its initial position concerning these witnesses was correct.

Liggett's other arguments concerning the use of prejudicial, inadmissible and improper evidence are based almost exclusively on B&W's closing argument. However, Liggett failed to object during closing argument to most of the statements which it now claims were so prejudicial as to warrant a new trial. The Fourth Circuit has emphasized that "[i]t is the universal rule that during closing argument counsel 'cannot as a rule remain silent, interpose no objections, and after a verdict has been returned seized for the first time on the point that the comments to the jury were improper and prejudicial.'" *Dennis v. General Elec. Corp.* 762 F.2d 365, 366-67 (4th Cir.1985) (quoting *United States v. Elmore*, 423 F.2d 775, 781 [5th Cir.] *cert. denied*, 400 U.S. 825, 91 S.Ct. 49, 27 L.Ed.2d 54 [1970], and *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 239, 60 S.Ct. 811, 851-52, 84 L.Ed. 1129 [1940]). Liggett had every opportunity in its rebuttal argument to clarify any arguments which it believed were misleading on the part of B&W. The alleged improprieties in B&W's closing argument do not involve any exceptional circumstances which would impair "the public reputation and integrity of the judicial proceeding." *Dennis*, 762 F.2d at 367; *see also Socony-Vacuum Oil*, 310 U.S. at 239, 60 S.Ct. at 851-52.

For the foregoing reasons, Liggett's motion for a new trial on the trademark and unfair competition claims will be denied.

An order and judgment in accordance with this memorandum opinion shall be entered contemporaneously herewith.

ORDER and JUDGMENT

For the reasons set forth in a memorandum opinion filed contemporaneously herewith,

IT IS ORDERED AND ADJUDGED that Defendant's motion for judgment notwithstanding the verdict pursuant to Rule 50(b), Federal Rules for Civil Procedure, be, and the same hereby is, GRANTED, and that the jury verdict and judgment in favor of the Plaintiff be, and the same hereby is, SET ASIDE, and judgment entered for the Defendant; and

IT IS FURTHER ORDERED that Defendant's alternative motion for a new trial pursuant to Rule 59, Federal Rules of Civil Procedure, be, and the same hereby is, DENIED; AND

IT IS FURTHER ORDERED that Plaintiff's motion for a new trial pursuant to Rule 59, Federal Rules of Civil Procedure, be, and the same hereby is, DENIED.

**STATUTORY PROVISIONS INVOLVED
UNITED STATES CODE
TITLE 15**

15 U.S.C. § 2; (Sherman Act §2)

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$10,000,000 if a corporation, or, if any other person, \$350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

15 U.S.C. §§ 13 (a); (Robinson-Patman Act § 2(a))

It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them: Provided, That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered: Provided, however, That the Federal Trade Commission may, after due investigation and hearing to all interested parties, fix and establish quantity limits, and revise the same as it finds necessary, as to particular commodities or class of commodities, where it finds that available purchasers in greater quantities are so few as to render differentials on account thereof unjustly discriminatory or promotive of monopoly in any line of commerce; and the

foregoing shall then not be construed to permit differentials bases on differences in quantities greater than those so fixed and established: And provided further, That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade: And provided further, That nothing herein contained shall prevent price changes from time to time where in response to changing conditions affecting the market for or the marketability of the goods concerned, such as but not limited to actual or imminent deterioration of perishable goods, obsolescence of seasonal goods, distress sales under court process, or sales in good faith in discontinuance of business in the goods concerned.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1992

LIGGETT GROUP INC.,
v. *Petitioner,***BROWN & WILLIAMSON TOBACCO CORPORATION,**
Respondent.

**On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Fourth Circuit**

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

In this primary-line price discrimination case under Section 2(a) of the Robinson-Patman Act, Petitioner Liggett challenged the uniform nationwide volume discounts offered by Respondent B&W on its low-price black-and-white generic cigarettes. Liggett charged that B&W used "predatory" volume discounts to drive up generic cigarette prices, thereby "slowing the rate of growth" of generics. Since Liggett conceded that B&W could not control prices by itself, Liggett proposed a theory of oligopoly recoupment to explain how B&W could recover its alleged "predatory investment" and thereby injure primary-line competition. According to Liggett's theory, although B&W and Liggett competed "tooth and nail" in the generic segment, all other competitors would "simply stand by and refrain from also selling generics or other low-cost products."

The district court granted judgment n.o.v. for B&W because the record evidence disproved Liggett's oligopoly recoupment theory and therefore Liggett did not demonstrate a reasonable possibility of competitive injury, as required by the statute. A unanimous Fourth Circuit panel affirmed. Accordingly, the sole question presented is:

Whether the Fourth Circuit correctly affirmed the district court's determination that Liggett failed to demonstrate factually the elements of its oligopoly recoupment theory of competitive injury.

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent Brown & Williamson Tobacco Corporation ("B&W") respectfully requests this Court to deny the Petition for writ of certiorari to the Fourth Circuit.¹

The unanimous panel decision of the Fourth Circuit, affirming j.n.o.v., holds that Petitioner Liggett failed to provide adequate factual support for its claim. Both courts confined their holding to Liggett's unique claim and the facts of this specific and "unusual" case, as Liggett's counsel has described it.² The panel decision does not support any of the sweeping legal propositions attributed to it by Liggett, nor does it conflict with any ruling of this Court or of any other court.

Liggett's predatory pricing claim, based on its novel theory of oligopoly recoupment, is unprecedented under the Robinson-Patman Act. Because there are no similar cases pending or likely to arise in the future, review of this unique case would have no precedential value. Liggett's Petition merely requests a third *de novo* review of the fact-bound determination made by both lower courts that Liggett did not adequately substantiate its claim.

For all of these reasons the Petition should be denied.

COUNTERSTATEMENT OF THE CASE

Factual Background

This is a primary-line price discrimination case under the Robinson-Patman Act brought by one competitor (Liggett) to challenge the uniform nationwide volume discounts offered unilaterally by another competitor, B&W. The suit concerns a volume-discount war triggered by

¹ Pursuant to Rule 29.1, B&W states that it is an indirect wholly owned subsidiary of B.A.T. Industries, p.l.c. Between B.A.T. Industries, p.l.c. and B&W are South Western Nominees Ltd. (U.K.), BATUS Holdings, Inc. and BATUS Tobacco Services, Inc. B&W has only wholly owned subsidiaries.

² P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 711.2, at 617 (Supp. 1991).

B&W's announcement of its first "black-and-white" generic cigarettes.³ The parties agree that the relevant market includes all cigarettes manufactured and distributed in the United States. B&W's share of this market never exceeded 12% at any relevant time.

There are six major U.S. cigarette producers: Philip Morris ("PM"), R.J. Reynolds ("RJR"), Lorillard, American, Liggett and B&W. Each company, including Liggett, sells branded cigarettes. PM and RJR are the largest firms in the industry with 41.9% and 28.5% shares respectively at time of trial. It is undisputed that B&W's U.S. cigarette business has been profitable at all times. At all times Liggett has been a profitable full-line competitor offering a variety of generic and branded cigarettes throughout the relevant market.

In 1980 Liggett began to produce generics in response to repeated requests from a major customer (Topco) for its own private-label cigarette. Petitioner's Appendix ("Pet. App.") 21a. Liggett soon began to produce private-label generics for other distributors and eventually offered its own black-and-white cigarettes, which it sold at volume discounts. *Id.* at 21a; JA5463-64.⁴

In July, 1983, RJR responded to the growth of black-and-white generics by introducing a "Value-25" brand, "Century"; B&W followed with its own Value-25, "Richland." Pet. App. 3a. By 1984 generics held almost 4% of the U.S. cigarette market, of which 97% were sold by Liggett. JA3035; JA4832-33.

In April, 1984, RJR repositioned "Doral"—a full-price brand—as a generic, offering volume discounts to make it directly price-competitive with Liggett's generics.

³ "Generic cigarettes" (or more simply "generics") include: (1) black-and-white generics—sold in nondistinctive packaging (including private labels) at a low price; (2) branded generics—cigarettes with some name-brand identity (*e.g.*, "Doral"), but sold at low prices equal to those of black-and-white generics; and (3) "Value-25's"—cigarettes sold in packs containing twenty-five cigarettes at the same price as twenty-cigarette packs.

⁴ "JA" refers to the Joint Appendix filed in the Fourth Circuit.

JA2071-72. Liggett immediately responded by increasing the volume discounts on its own generics. JA2902-03.

B&W had begun to investigate the possibility of manufacturing black-and-white, private label and branded generics in late 1983. JA7255-56. After RJR's aggressive discounting of Doral in April, 1984, B&W concluded that offering new generic items would be critical to stopping the decline in its market share. JA1691 at ¶ 11.

In May, 1984 B&W's internal planning process culminated in a final proposal, in the form of a formal written document, sent by B&W to its then-corporate parent, BATUS. JA5957-58. B&W proposed to introduce a black-and-white generic cigarette and requested that, if required by future competitive necessity, it should have discretion to price the new black-and-whites at "break-even" levels. This final proposal summarized the competitive situation as follows:

"B&W believes that branded generics will enhance the growth of the economy segment and will draw volume from popular priced brands.

....

The earlier concern of expanding the economy segment is no longer tenable, given RJR's recent action. It is clear that the economy segment is significant, and growing. Accordingly, recognizing the importance of minimizing increased cannibalization and concomitant share erosion, as well as maintaining trading profit targets, it is imperative that B&W enter this segment."

Pet. App. 5a (emphasis supplied). Indeed, this final proposal was based on the projection that generic cigarette sales would grow to 10% of the market by 1988—more than doubling the segment's share in less than five years. The final proposal also projected that generic prices would remain at a 35% discount from branded cigarettes throughout this five-year period. JA1422; JA1434.⁵

⁵ Accordingly, the final B&W proposal was not based on "manag[ing] the price of generic cigarettes upward," Pet. 9, or "slowing the rate of growth of the generic segment," *id.* at 11, as Liggett

BATUS accepted B&W's proposal to introduce a black-and-white generic, but only subject to the condition that it be priced to return at least \$1.00 per thousand cigarettes in trading profit. JA6054. BATUS rejected the proposal to consider break-even pricing in the future. JA6016; JA6054. B&W moved quickly to introduce generics priced within BATUS' trading profit constraint. JA4765. In light of the volume discounts already provided by both RJR and Liggett on their generics, B&W believed that volume discounts were essential to the success of its new generics. JA1731-32; JA2903; JA8158-60. The RJR executive responsible for repositioning Doral testified that B&W's belief was accurate. JA7864.

On May 31, 1984, B&W announced the introduction of its new generics. JA50. Simultaneously, B&W announced a list price and discount schedule for these generics, including volume discounts up to thirty cents per carton. JA60. B&W's announcement triggered an immediate increase in volume discounts and other promotional spending by Liggett. JA2905; JA4804-09; JA7332. When B&W responded, Liggett again increased its volume discounts. This cycle was repeated a total of five times. JA4804-09. B&W never increased its volume discounts except in response to an increase by Liggett. JA4286-87.

With each successive volume discount increase, B&W confirmed internal projections showing that it would make a profit on its new generics at the announced price and discount level.⁶ JA2082-83; JA7573-81; JA7583-91. At no

alleges. To the contrary, the final proposal was based on expectations of continued substantial discounts, intensifying low-price competition and sustained and rapid expansion of the generic segment.

⁶ B&W did not concede that it set below-cost prices for its generics, as Liggett insinuates. Pet. 8 n.12. Although Liggett also asserts that the jury found below-cost pricing by B&W, *id.* at 11, this too is incorrect: despite B&W's request for a jury instruction requiring such a finding, no such instruction was given, and the general verdict did not contain a finding of below-cost pricing. JA667-68; JA7944-45.

time did B&W ever expect, intend, or reasonably anticipate that its black-and-white generics would be unprofitable.⁷ Indeed, Liggett concedes that the price and volume discount schedule initially announced by B&W was above cost. JA6901-02; JA7582. Liggett also concedes that B&W's full line of cigarettes has been profitable at all relevant times.

From then on, as Liggett's president confirmed, "competition . . . substantially increased in the total cigarette market," and the cigarette manufacturers fought "tooth and nail." Pet. App. 6a. Other Liggett witnesses confirmed that after B&W's introduction of black-and-whites the market "got very competitive," *id.*, that Liggett "had some competition for a change," JA6193, and that competition among Liggett, B&W and RJR resulted in increased price competition and lower prices, JA5934; JA7826-27. Liggett's economic theory witness admitted that generic competition exerted downward pressure on branded cigarette prices. JA6814.

At the time of B&W's 1984 announcement Liggett accounted for 97% of all U.S. sales of black-and-white generics. Although by 1990 four of the six U.S. cigarette firms were offering black-and-white generics, Liggett still held the largest share of black-and-white sales. JA5411; JA5414; JA5418; JA5420; JA5426. Throughout the alleged "period of predation" identified by Liggett, Liggett held no less than 80-85% of all black-and-white generic sales. JA4834-37; JA6270-71; JA7360-61; JA7363-64.

The Fourth Circuit summarized the subsequent explosion of discount cigarette competition, noting that "[w]hile the United States market for cigarettes has been generally declining, *the growth of discounted cigarettes has been dramatic.*" Pet. App. 6a (emphasis supplied). This "dramatic" industry-wide growth included Liggett, whose

⁷ "[I]t is the [defendant's] projections which are legally relevant, since those projections would have formed the basis for [its] business decisions at the time." *Hoyt Heater Co. v. American Appliance Mfg. Co.*, 502 F. Supp. 1383, 1388 (N.D. Cal. 1980).

generic cigarette sales more than tripled from 1981 (2.8 billion) to 1988 (9 billion). *Id.* Every cigarette manufacturer introduced a generic cigarette. Total industry sales of generics went from 2.8 billion in 1981 to 61.6 billion in 1988 and then to nearly 80 billion (15% of the total cigarette market) at the time of trial—more than a twenty-eight-fold increase. *Id.* The most recent available industry data show that from the 4% level in 1984, when B&W introduced its black-and-whites, the discount segment now occupies 28% of the entire U.S. cigarette market.⁸ While Liggett claims that black-and-whites held only 2.7% of the market in 1989, Pet. 11, *black-and-white generics alone now account for 12.2% of the entire U.S. cigarette market.*⁹

At the time of trial five cigarette producers offered discounts of at least 50% off the price of nationally advertised brands, far exceeding the 35.7% discount offered by Liggett at the time B&W announced its new generics. JA4277; JA5303; JA7406-11; JA7905. Liggett's director of national sales confirmed that consumer savings attributable to cigarette discounting had risen nearly ten-fold following B&W's introduction of its black-and-whites, from \$375 million in 1980-84 to almost \$3.5 billion in the period 1984-89. Trial transcript, day forty-four at 116-118.

The District Court Proceedings

Just weeks after B&W's announcement of its generics—before the last round of volume discount increases and before the first B&W black-and-whites were actually shipped—Liggett had already filed this lawsuit as a trademark infringement and unfair competition claim (both eventually lost and not appealed by Liggett). Liggett's original complaint, filed to "thwart" B&W's introduction of generics, JA4768; JA5017, did not contain an antitrust count. Two weeks later Liggett added a

⁸ *Maxwell Consumer Report* at 4 (July 30, 1992) ("Price-Value Category Shares by Type: Second Quarter-1992") (hereinafter "*Maxwell Consumer Report*").

⁹ *Id.*

treble-damage claim under Section 4 of the Clayton Act, 15 U.S.C. § 15, based on alleged price discrimination by B&W in violation of Section 2(a) of the Clayton Act, as amended by the Robinson-Patman Act, 15 U.S.C. § 13(a).

Liggett's first antitrust claim asserted that B&W discriminated in price between its higher-priced, nationally advertised branded cigarettes on one hand and its lower-priced black-and-whites on the other. When B&W moved for summary judgment on this claim Liggett again amended its complaint, this time alleging that the discrimination arose from the volume discounts granted on B&W's black-and-whites alone.

Before trial the district court granted partial summary judgment for B&W on the first antitrust allegation (discrimination between branded and generic cigarette prices), and Liggett did not appeal. Accordingly, B&W's volume discounts on black-and-white generics are the only specific B&W conduct relied upon by Liggett in order to support its remaining antitrust claim.¹⁰

Liggett's remaining claims were tried; a jury returned a verdict for Liggett on its antitrust claim and for B&W on Liggett's remaining claims. Pet. App. 18a-19a. B&W filed motions for j.n.o.v. or new trial on Liggett's antitrust claim. The district court granted B&W's motion for j.n.o.v. and denied the new trial motion. *Id.* at 19a.

The district court set aside the antitrust verdict for Liggett based on Liggett's failure to establish each of three distinct elements essential to its Robinson-Patman claim: (1) primary-line competitive injury, required by Section 2(a); (2) a causal link between alleged price

¹⁰ Liggett incorrectly asserts that B&W "admitted" price discrimination. Pet. Questions Presented. As the district court specifically noted, "[e]xcept for the issue of price discrimination, the jurisdictional elements [of Liggett's Robinson-Patman claim] are undisputed." Pet. App. 23a-24a (emphasis supplied; footnote omitted). B&W did not "discriminate" within the meaning of Robinson-Patman because the same discounts were available to all of its generic cigarette customers.

discrimination and any competitive injury, also required by Section 2(a); and (3) antitrust injury, required by Section 4 of the Clayton Act.

Liggett charges that the lower courts "did not credit the jury verdict." Pet. 12. According to Liggett, the jury found that B&W had engaged in "loss creating price cutting," with a "real possibility" of "recoup[ing] such losses" from "prices higher than competitive levels," thus creating a "reasonable possibility of injuring competition in the cigarette market as a whole." *Id.* at 11 (quoting JA7940-42). These assertions are incorrect.

The court's instructions permitted a finding of competitive injury based on an inference of "predatory intent," derived exclusively from statements contained in some B&W internal documents. JA7944-45. The Petition asserts that Liggett "does not contend that B&W's anti-competitive motive in itself violates the statute." Pet. 7 n.11. It therefore appears that Liggett now accepts the view of the district court in its j.n.o.v. ruling: "An avowed predator with no prospect of controlling prices is a paper tiger unable to harm consumer welfare." Pet. App. 33a.¹¹

"[B]ased on interpretations of the applicable law," the district court's j.n.o.v. ruling repudiated instructions that were "generally consistent with the legal position and theory espoused by Liggett." *Id.* at 18a n.4, 19a n.6. Since the jury's general verdict was based on these legally defective instructions, it was untenable in any event. *Sunkist Growers, Inc. v. Winckler & Smith Citrus Products Co.*, 370 U.S. 19, 30 (1962) (general verdict of anti-trust liability which rested on one legally defective ground among several others "cannot be upheld"). With a com-

¹¹ The district court also realized in granting j.n.o.v. that the instructions given regarding a possible generic cigarette "submarket" were not only contrary to the parties' agreement on relevant market but also unsupported by "substantial economic evidence." Pet. App. 46a & n.43. See also n.6, *supra*, regarding the court's failure to give instructions that would have required the jury to find below-cost pricing.

plete view of the law and the record, the district court recognized that the case should not have been submitted to a jury in the first place, for the following reasons:

No Competitive Injury: Liggett's claim of primary-line injury under the Robinson-Patman Act rested entirely on one expert witness' unprecedented and unique theory of oligopoly recoupment. Liggett claimed that B&W used predatory volume discounts to drive up black-and-white prices and that B&W would "recoup" its "predatory investment" because "thereafter no other member of the oligopoly offered or pushed such a deeply discounted product" ¹² As the district court recognized, if "any of the other major cigarette manufacturers were interested in promoting the sale of generic cigarettes, even Burnett [Liggett's economic theory witness] admitted that successful predation by B&W would be impossible." Pet. App. 36a (emphasis supplied).

The district court described Liggett's oligopoly recoupment theory as "dubious." *Id.* at 33a. While noting there was "little legal precedent" to support it, the district court stated that "in rejecting it the court need not rule that this theory is insufficient as a matter of law." *Id.* at 34a. Rather there was "[n]o substantial record evidence" to support the theory. To the contrary:

Even before B&W began selling black and white cigarettes, RJR had entered the generic segment by repositioning Doral at generic prices. . . . Furthermore, there is no evidence that any of the other major cigarette companies had an interest in slowing the growth of generic cigarettes.

Id. at 36a. Faced with this competition, B&W could not and did not control generic cigarette prices. The district court noted the undisputed fact that B&W's *only* attempt to lead a generic price increase (in December, 1985) was

¹² Brief of Plaintiff-Appellant and Cross-Appellee [Liggett] at 3-4 (filed in the Fourth Circuit) (hereinafter "LB").

a complete failure because no other manufacturer followed. *Id.* at 36a, 38a n.36.¹³

Liggett asserts that the result of B&W's use of volume discounts was to "slow[] the rate of growth" of black-and-whites and reduce the percentage differential between the price of black-and-whites and branded cigarettes. Liggett complains that the market share held by black-and-whites declined to 2.7% by 1989. As the district court recognized, however, Liggett's focus on black-and-whites is meaningless because of "steady growth" in the overall generic segment, including other generics "sold at the same price as black and white cigarettes." *Id.* at 38a n.36. The market share of all generics reached 15% by the close of trial and today it stands at 28%.¹⁴

Similarly, Liggett asserts that the differential between branded and black-and-white cigarette prices declined to 26.8% in 1989. Pet. 10. This, too, is a pointless and misleading calculation. First, like Liggett's "growth" figures, it is limited only to black-and-white generics. Second, Liggett considers only *its own* black-and-white cigarettes, ignoring that by time of trial B&W and

¹³ At trial it was uncontroverted that "the *only* time Brown & Williamson *ever* tried to lead a price increase" on generics was in December, 1985. JA6017 (emphasis supplied). The district court recognized this, referring to the abortive attempt as the "only" such incident. It was not until Liggett filed its Reply Brief in the Fourth Circuit that Liggett first accused B&W of "successful *leading* of generic cigarette price increases . . . in June 1986, in December 1987, and in June 1988 . . ." Reply Brief of Plaintiff-Appellant and Cross-Appellee [Liggett] at 20 (filed in the Fourth Circuit) (hereinafter "LRB") (emphasis supplied). This unsupported allegation is repeated in Liggett's Petition. Pet. 10.

The record shows at most that B&W preceded Liggett in a sequence of price changes, but the record does not support any assertion that B&W, as opposed to PM, RJR or another manufacturer, initiated any such change.

¹⁴ Even accepting Liggett's narrow focus, the current market share of black-and-white generics alone now stands at 12.2%—more than triple the share they held when Liggett was virtually the only competitor offering that item. *Maxwell Consumer Report* at 4.

RJR offered black-and-whites at a discount of 50%. JA7407; JA7905. In 1988 Liggett itself introduced a sub-generic, "Pyramid," at discounts of more than 50% off branded. JA4957; JA5303. By the end of trial five of the six major competitors offered cigarettes at discounts of at least 50% off branded prices.¹⁵ JA5303; JA7406-11; JA7905.

The district court also recognized that Liggett's oligopoly recoupment theory "was contradicted by witnesses from the Liggett boardroom" in the form of "unequivocal . . . trial testimony from the senior executives at Liggett who made the pricing decisions." Pet. App. 34a-35a. Although Liggett's theory assumed "tacit collusion" among cigarette manufacturers, Liggett's senior executives denied any suggestion of "tacit collusion," Pet. App. 6a; JA5801; JA7185-87; and affirmed that "[t]he public has not been denied the benefits of free and open competition in the cigarette industry." JA5670.

Liggett seeks to explain this fundamental contradiction by claiming that its senior executives simply did not understand economic concepts like "competition." Pet. 5 n.9. The district court rejected this explanation for Liggett's "obvious problem":

[T]hese executives gave basically the same testimony at their depositions. The court allowed the case to go to trial in part because of affidavits from the Liggett executives stating that they were confused However, at trial, despite having consulted extensively with Burnett [Liggett's economic theory witness] and having had adequate time to familiarize themselves with concepts such as tacit collusion, oligopoly, and monopoly profits, these Liggett executives again contradicted Burnett's theory.

¹⁵ Again, Liggett's assertions are meaningless even within their intended frame of reference. Even if the differential between Liggett's own branded and generic cigarettes had been only 26.8%, this would have been within the 25-30% range considered necessary for generics to be "successful" according to Liggett's own executives. JA5621; Trial transcript, day forty-four at 108.

Pet. App. 35a. As the district court correctly ruled, the problem was not "confusion"; the problem was that Liggett's senior executives with direct responsibility for pricing—including Liggett's president and its senior vice president for sales and marketing, among others—emphatically denied the central contention underlying Liggett's oligopoly recoupment theory. *See id.* at 35a.

In sum, the district court recognized that both the objective market evidence and the testimony of Liggett's senior executives contradicted the oligopoly recoupment theory. The district court therefore held correctly that Liggett had failed to substantiate its unprecedented economic theory of primary-line injury through oligopoly recoupment.

No Causation: The district court also held that, as a matter of law, Liggett failed to establish that any alleged competitive effects were "the effect of" B&W's alleged price *discrimination*, an explicit requirement of Section 2(a), as distinct from the mere low *level* of B&W's generic cigarette prices. Pet. App. 38a-42a. Liggett alleged that B&W's generic prices were below its own, regardless of volume. Thus, according to Liggett's own theory, any alleged impact on competition could have arisen only from

the low prices that B&W offered to its customers and not from the fact that these low prices varied depending on volume. . . . Liggett was not disadvantaged any more by B&W's volume rebates than it would have been by one uniform low price.

Id. at 40a. Thus, Liggett failed to demonstrate any causal connection between the alleged effects and the price *differences* contained in B&W's volume discount schedule.

No Antitrust Injury: Finally, following *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990), the district court held that Liggett's failure to substantiate its claim of predatory pricing undercut any assertion that B&W's volume discounts had caused antitrust

injury.¹⁶ Liggett and B&W "were both profitable, full product line competitors with access to the same customers and markets." Pet. App. 48a. Moreover, "B&W made money on its overall cigarette sales—branded and generic—during the alleged predatory period." *Id.* at 46a. "[R]ivals generally can hardly be ruined so long as prices for the product line as a whole are compensatory." *Id.* at 47a (quoting P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 715.1a, at 592 (Supp. 1989)). Thus, the district court correctly rejected Liggett's attempt to show predatory pricing by focusing on only one isolated item in the full product line offered by Liggett, B&W and other U.S. cigarette producers.¹⁷

The Fourth Circuit's Affirmance

Affirming the district court ruling, the Court of Appeals exposed the fatal flaw in Liggett's competitive injury showing. The court concluded that Liggett was unable to demonstrate an essential element of its primary-line Robinson-Patman case because it could not factually substantiate its theory of oligopoly recoupment. Pet. App. 14a.

As presented by its economic theory witness, Liggett's theory conjectured that B&W, after raising prices on generics, Pet. Questions Presented, could "recoup" its "predatory investment" by relying on predictions about the cigarette "oligopoly." Critical to Liggett's theory, however, was an asserted B&W "expectation" that "the other members of the oligopoly would not intercede" but

¹⁶ Because antitrust injury is an element of standing, *Associated General Contractors, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 539-41 (1983), the district court held that Liggett's failure to show antitrust injury also deprived it of standing to seek treble damages under Section 4 of the Clayton Act. Pet. App. at 42a-48a.

¹⁷ Liggett sought to avoid the force of this ruling by arguing that it "relied heavily" on black-and-whites. LB 30. But in 1983, 75% of Liggett's profits were attributable to branded cigarettes. JA5177; JA7431-32. Indeed, Liggett itself described full-price cigarettes as its "life blood." JA4955.

would "simply stand by and refrain from also selling generics or other low-cost products . . ." Pet. App. 11a.¹⁸

Any such expectation of inaction by oligopolists facing a price war would not only have been "irrational," but was also contradicted by the "actual experience in this case"—i.e., the discount war that broke out in May, 1984. *Id.* Indeed, that actual experience began with market developments, including a major initiative in the generic segment by industry giant RJR, that led B&W to conclude that its "earlier concern of expanding the economy segment is no longer tenable," and to "predict similar actions as occurred," namely, "dramatic" generic growth. *Id.* at 5a, 6a, 12a. Those B&W expectations were realized when "most cigarette manufacturers were offering various types of low-priced cigarettes, including generics," and as sales jumped from 2.8 billion units (0.4% market share) in 1981 to 80 billion (15% share) in 1989. *Id.* at 12a-13a.

In sum, Liggett's theory, which *assumed* that members of the oligopoly would "simply stand by and refrain" from offering generics and thus "act uncompetitively" in the face of "a competitive move" by others was unsubstantiated and indeed contradicted by the "actual experience in this case." *Id.* at 11a, 13a. Accordingly, Liggett failed to establish its theory of oligopoly recoupment, the linchpin for the essential element of competitive injury in this primary-line price discrimination case.¹⁹

¹⁸ Throughout the Petition, Liggett confuses its own theory, as developed by its economic theory witness (and as deemed unsubstantiated by both courts below), with the Court of Appeals' asserted "economic theory"—and then assails the court's reasoning as "theoretical speculation." Pet. 12, 14, 15. But the issue in this case is whether *Liggett's* theory was in accord with the record. Both courts correctly held that it was not.

¹⁹ In view of its holding, the Fourth Circuit did not reach any of the alternative independent grounds for affirmance, including (1) absence of causation under Section 2(a), (2) absence of anti-trust injury, and (3) legally inadequate proof of damages.

Similarly, the court had no reason to consider either B&W's conditional cross-appeal (from the district court's rejection of its

REASONS TO DENY THE WRIT

I. THE FOURTH CIRCUIT DECISION MADE NONE OF THE SWEEPING LEGAL RULINGS ATTRIBUTED TO IT BY LIGGETT: LIGGETT'S "QUESTIONS PRESENTED" ARE PURELY HYPOTHETICAL AND ARE NOT PRESENTED BY THIS CASE

The Fourth Circuit's decision is based on a proper understanding of the law and a thorough evaluation of the entire record. The court made none of the sweeping legal rulings attributed to it by Liggett. It held only that Liggett's unique theory of oligopoly recoupment was decisively contradicted by the critical undisputed facts. Thus, Liggett's alleged "questions presented" are academic issues without significance to this case.

Liggett asserts that the Court of Appeals (1) granted "[p]er se immunity for disciplinary price discrimination"; (2) "held that, absent a conspiracy, an oligopolist could never . . . threaten competition," and (3) "limited liability under the Robinson-Patman Act for predatory price discrimination to instances where the defendant is a monopolist or a conspirator." Pet. 2, 14. Liggett also asserts that these and other equally sweeping legal determinations were contrary to the "language and purpose," *id.* at 14, of the "statutory provision at issue here [which] was part of the 1914 Clayton Act . . ." *Id.* at 2. Based on these and other mischaracterizations of the Fourth Circuit opinion, Liggett goes on to find "misunderstandings" of and "conflicts" with various rulings of this Court and the courts of appeals.

Each of Liggett's assertions is incorrect. None of the broad legal propositions attacked by Liggett can be found in the language or implications of the Fourth Circuit's opinion. The Court of Appeals, like the district court, correctly ruled that Liggett simply did not substantiate

new trial motion and its omission of any substantive discussion of several of the alternative independent grounds) or B&W's supplemental appeal. B&W has not cross-petitioned before this Court but would reassert such matters if appropriate in any further proceedings.

factually its unique claim of oligopoly recoupment. Neither court addressed any broad issues of antitrust doctrine because there was no need to do so.

Liggett also accuses the Fourth Circuit of "judicial theorizing," Pet. 19, and of harboring "an idiosyncratic and illogical view of economic theory . . ." *Id.* at 2. Liggett quotes out of context a reference to "economic logic" and converts it into an asserted holding that "only a monopolist . . . or a member of an organized cartel" could engage in predation. *Id.* at 12. But the court's full statement is that "economic logic *as well as actual experience in this case*" are inconsistent with Liggett's unique claim. Pet. App. 11a (emphasis supplied).²⁰ Because Liggett's claim is inconsistent with the facts of this case, any comments the court may have made about the logic of Liggett's unique economic theory are immaterial to its holding. This Court "reviews judgments, not statements in opinions." *Black v. Cutter Laboratories Corp.*, 351 U.S. 292, 297 (1956).

B&W respectfully submits that this Court should not exercise its certiorari jurisdiction merely to confirm for yet a third time that the oligopoly recoupment theory advanced by Liggett fails to square with the critical undisputed facts in this specific record.

A. The Fourth Circuit Did Not Require Monopoly or Conspiracy as a Basis for Proof of Primary-Line Injury

Liggett asserts that the Court of Appeals "limited liability under the Robinson-Patman Act for predatory price discrimination to instances where the defendant is

²⁰ Similarly, Liggett asserts that the Fourth Circuit required predation claims to be supported by evidence that the prospect of recoupment is "certain." Pet. 12. The Court of Appeals' statement refers, however, to the "oligopolists on the sidelines"—i.e., the bystanders in the price war, as distinct from the alleged predator. Pet. App. 11a. With respect to the alleged predator, by contrast, the court clearly stated that only a "rational expectation" of recoupment need be shown. *Id.* at 9a.

a monopolist or conspirator." Pet. 2. This assertion is unsupported by any language in the court's opinion. Indeed, the opinion is clearly inconsistent with Liggett's assertion. The court held only that the undisputed record evidence fatally contradicts Liggett's oligopoly recoupment theory.²¹

Like the district court, the Fourth Circuit found the undisputed record evidence inconsistent with Liggett's claim that B&W could recoup by relying on all other competitors to "simply stand by and refrain from selling generics . . ." Pet. App. 11a. In view of the three-firm generic competition already underway when B&W introduced its black-and-whites, "[a]ny rational observer would have known that sales of Richland, Century, and Doral would most likely further erode the sales of full-priced branded cigarettes, regardless of Brown & Williamson's success in disciplining Liggett . . ." *Id.* at 12a. But the Court of Appeals had no need to "impute rationality" to B&W, *id.*, since B&W's final, formal written proposal to its parent, which requested permission to introduce a low-price black-and-white generic, clearly and specifically adopted this perspective:

The very memoranda upon which Liggett relies so heavily as evidence of Brown and Williamson's predatory intent not only predict similar actions as occurred, but conclude after the introduction of Doral that "[t]he earlier concern of expanding the economy segment is no longer tenable . . ."

Id. Thus, "[t]he facts in this case remove any doubt" regarding B&W's expectations of further generic competition and discount growth. *Id.* B&W's final proposal was not based on projections of the demise of black-and-whites, or a declining price differential between generics

²¹ In this respect the Fourth Circuit was simply approaching the case as the district court had done:

Although there is little legal precedent supporting Burnett's shared market power theory, in rejecting it the court need not rule that this theory is insufficient as a matter of law.

and branded, as Liggett asserted. To the contrary, the projections envisioned intensifying competitive reactions and growth of the segment to 10% of the market within five years, based on a persistent 35% discount. JA1422; JA1434.

Finally, the Fourth Circuit recognized, as did the district court, that the undisputed evidence showed that B&W's rational prediction of expanded discount competition was amply fulfilled:

Soon after the events of 1984, most cigarette manufacturers were offering various types of low-priced cigarettes, including generics, and by trial all were vigorously competing with differing devices and approaches. Sales of low-priced cigarettes increased from 2.8 billion cigarettes in 1981 to nearly 80 billion in 1989. Their proportional share of the overall cigarette market in the United States grew from .4% to 15%.

Pet. App. 12a-13a.

Thus, Liggett's assertion that the Fourth Circuit required monopoly or conspiracy as a matter of law is incorrect. The court simply found that Liggett's oligopoly recoupment theory was fatally contradicted by key undisputed facts.

B. The Fourth Circuit Did Not Rule Oligopoly Either *Per Se* Legal or Immune from Antitrust Liability

Petitioner Liggett asserts that the Fourth Circuit "immunized" oligopoly behavior, Pet. Questions Presented, "created a rule of *per se* legality," Pet. 12, and held that "[a]n oligopolist's below-cost investment . . . could never pay off" *Id.* Again, these contentions are contradicted by what the Fourth Circuit actually said.

The Fourth Circuit simply compared the assertions of "Liggett's theory," Pet. App. 10a, 11a (emphasis supplied), with the undisputed facts of record. While Liggett's oligopoly recoupment theory pictured Liggett as a lone "maverick," sales of Richland, Century and the

repositioned Doral were already underway by May of 1984. The repositioning of Doral caused B&W to conclude that "[t]he earlier concern of expanding the economy segment is no longer tenable" Pet. App. 12a. Moreover, while Liggett's oligopoly recoupment theory envisioned that "neither Brown & Williamson nor any of the other manufacturers would expand its own sales of low-priced cigarettes," in fact "[s]oon after the events of 1984, most cigarette manufacturers were offering various types of low-priced cigarettes . . . and by trial all were vigorously competing with differing devices and approaches." *Id.*

The Fourth Circuit's holding rests entirely on the factual insufficiency of Liggett's support for its oligopoly recoupment theory. It does not rely on any principle of oligopoly "immunity" or alleged rule of "*per se* legality."

C. The Fourth Circuit Did Not Rest Its Decision on "An Idiosyncratic and Illogical View of Economic Theory"

Liggett also accuses the Court of Appeals of adopting "an idiosyncratic and illogical view of economic theory," Pet. 2, of "denying the factual basis" for Liggett's claim in favor of "theoretical speculation," *id.* at 12, and of using "judicial theorizing" to "trump clear evidence," *id.* at 19. Liggett has simply reversed reality: it is Liggett that attempts to substitute its economist's unprecedented theory of oligopoly recoupment for the undisputed facts regarding market developments.

This Court recently warned against the use of economic theory to trump record evidence, as Liggett proposes here. In *Eastman Kodak Co. v. Image Technical Services, Inc.*, — U.S. —, 112 S. Ct. 2072 (1992), the Court noted its long-standing preference "to resolve antitrust claims on a case-by-case basis, focusing on the 'particular facts disclosed by the record[,]'" and to "examine[] closely the economic reality of the market at issue." 112 S. Ct. at 2082 (footnote, citations omitted).

The Court of Appeals acted in full accord with this continuing historic practice.

This case presents an even more compelling basis to prefer facts and reality over theory than did *Eastman Kodak*: both courts below had the benefit of a full trial record, whereas *Eastman Kodak* involved a summary judgment rendered after only “truncated discovery.” *Id.* at 2076. Moreover, *Eastman Kodak* involved exclusionary and “facially anticompetitive conduct”—“exactly the harm that antitrust laws aim to prevent.” *Id.* at 2088. By contrast, this case involves “just the opposite” type of conduct—unilateral price cutting.

Because cutting prices to increase business is “the very essence of competition,” the Court was concerned that mistaken inferences would be “especially costly,” and would “chill the very conduct the antitrust laws are designed to protect.”

Id. (quoting *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986) (citations omitted)).

Liggett suggests that the Fourth Circuit’s ruling conflicts with *Eastman Kodak*, and Liggett even requests a “remand for reconsideration in the light of *Kodak*.” Pet. 19 & n.24; cf. Pet. Questions Presented. But the Fourth Circuit *did* consider *Eastman Kodak*, because Liggett summarized and circulated the opinion to every Fourth Circuit judge while Liggett’s petition for rehearing *en banc* was pending. (Letter dated June 9, 1992 from P. Areeda to Clerk, Ct. of App. for the 4th Cir.) Apparently unimpressed by Liggett’s assertions that the panel had abused economic theory to adopt rules of “*per se* legality,” no member of the Fourth Circuit requested a poll on the suggestion for rehearing *en banc*. Pet. App. 15a.

Because the Fourth Circuit properly relied on the undisputed record evidence to reject Liggett’s novel oligopoly recoupment theory, its ruling accords with *Eastman Kodak*. Furthermore, its doubts about Liggett’s oligopoly recoupment theory were hardly “idiosyncratic” or “illogi-

cal.” The very economic authorities relied upon by Liggett observe that oligopoly is inherently “uncertain” in light of the “traditional theory that ‘anything can happen’ in oligopoly.” F. Scherer & D. Ross, *Industrial Market Structure and Economic Performance* 220 (3d ed. 1990). See also II P. Areeda & D. Turner, *Antitrust Law* ¶ 404b2, at 276 (1978) (“effective price coordination among oligopolists . . . will not be possible when any significant firm chooses, for any reason, to ‘go it alone.’”); *id.*, ¶ 404b3, at 277 (oligopoly stability “will quickly evaporate if rivals misread a price change or make disparate responses, as they are likely to do”).

The volume-discount war that erupted when B&W announced a major new discount item was therefore entirely in accord with the predictions of the “traditional theory.” Liggett’s theory, by contrast, rested on the conjecture that B&W offered its black-and-whites expecting “that all the other oligopolists . . . would simply stand by and refrain from also selling generics” despite the ongoing price war. It was this conjecture that caused the court to observe:

Such confidence must be rare, indeed, when the form that the discipline takes is a price-war, which must strike fear in the heart of any oligopolist hoping to protect market share and high prices.

Pet. App. 12a.

Unlike the plaintiff in *Eastman Kodak*, Liggett had an opportunity to test its theory against facts developed through full discovery. Liggett’s theory simply failed that test. As the Fourth Circuit recognized, it was Liggett’s theory—not “traditional theory”—that was contradicted by the three-way competition that already existed in 1984, by “the very memoranda” of May, 1984 that demonstrated B&W’s expectation of intensifying generic competition, and by the “dramatic” growth of discounted cigarettes from 1984 onward.

In sum, Liggett's accusation that the Fourth Circuit used "theoretical speculation" to "trump evidence" has no substance. The court clearly rested its holding on Liggett's failure to substantiate factually *its own* theory of oligopoly recoupment.

D. The Fourth Circuit's Decision Does Not Conflict With Any Decision of This or Any Other Court

No conflict can arise from the Fourth Circuit's fact-bound determination that Liggett failed to substantiate its claim. Both courts engaged in a thorough review of the record based on a clear appreciation of controlling law. Liggett's attempt to suggest "conflict" is again based on a mistaken view of the panel decision.

1. The Fourth Circuit correctly distinguished *Utah Pie*

Liggett insists that the Fourth Circuit is alone, Pet. 20, in its interpretation of this Court's ruling in *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967). The assertion is incorrect: the Fourth Circuit carefully differentiated Liggett's unusual primary-line, non-geographic Robinson-Patman Act claim from the typical primary-line Robinson-Patman case exemplified by *Utah Pie*. Pet. App. 8a. According to the appellate court, "[i]n *Utah Pie*, national competitors, using economic muscle from sales in markets other than Salt Lake City, had subsidized below-cost pricing in the Salt Lake City area," *id.*—*i.e.*, the prototypical primary-line case involving "a large national manufacturer using predatory pricing tactics to displace a local competitor." *Id.* at 26a.

Liggett's challenge to B&W's nationwide quantity discounts, following the introduction of such discounts by Liggett and RJR (two competitors with "staying power" in parity with B&W), cannot give rise to either the subsidization or recoupment characteristic of Robinson-Patman primary-line cases involving geographic predation.²²

²² Liggett's insinuation that *Utah Pie* reflects more "modest" facts than this case, Pet. 20 n.26, only highlights Liggett's inability to

Similarly, no conflict exists with other Robinson-Patman primary-line injury decisions.²³ Liggett cites no case—under the 1914 or 1936 versions of the Clayton and Robinson-Patman Acts—in which liability was imposed in a competitor's primary-line case based on geographically uniform volume discounts, the only type of discount at issue here.

2. Other assertions of "conflict" are unsupportable

Entirely academic is Liggett's request for "this Court to resolve the conflict among the circuits as to the need for the prospect of recoupment under the Robinson-Patman Act . . ." Pet. 21. Whatever the courts' final word on the "need for the prospect of recoupment" under Robinson-Patman, the issue is moot as to Liggett in *this* case, for Liggett adopted a theory of oligopoly recoupment but simply failed to support it.

Both Liggett's antitrust counsel and its economic theory witness agreed that without recoupment, Liggett's case "doesn't make sense," "because rational predatory behavior that makes sense" requires "recoupment" by "getting that money back plus a little more." JA6295-96.

overcome the factual deficiencies in its own efforts to substantiate the predation/recoupment claim against its competitor B&W.

Since *Utah Pie* has no implications for *this case*, review by this Court is hardly warranted simply because "*Utah Pie* has not fared well in the lower courts," Pet. 20, or among academic critics. III P. Areeda & D. Turner, *Antitrust Law* ¶ 720c, at 189-90 (1978) (*Utah Pie* "failed to focus on the important issues").

²³ Liggett's attempt to fabricate a conflict with *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396 (7th Cir. 1989), *cert. denied*, 494 U.S. 1019 (1990), Pet. 20-21, is ineffective. Whatever the merits of Judge Easterbrook's extended *dictum* on lower court interpretations of *Utah Pie*, the court's holding on the primary-line Robinson-Patman claim rests squarely on the determination that plaintiff failed to adduce sufficient evidence of price differences on comparable sales, a fundamental jurisdictional requirement of the Act. 881 F.2d at 1408. Liggett concedes that the case was "lost for other reasons . . ." Pet. 21.

Indeed,

predation in any meaningful sense cannot exist unless there is a temporary sacrifice of net revenues in the expectation of greater future gains. . . . Thus, predatory pricing would make little economic sense to a potential predator unless he had (1) greater financial staying power than his rivals, and (2) a very substantial prospect that the losses he incurs in the predatory campaign will be exceeded by the profits to be earned after his rivals have been destroyed.

III P. Areeda & D. Turner, *Antitrust Law* ¶ 711b, at 151 (1978).

Liggett's entire presentation before the Fourth Circuit—in briefs and oral argument—urged the *factual* sufficiency of its proof of recoupment, nowhere challenging the need for recoupment as a matter of law.²⁴ Conspicuously, Liggett's detailed and extensive Statement of Issues, LB1-2, raised *solely* factual matters. Liggett's "primary issue presented in [its] appeal" to the Fourth Circuit was "whether the evidence suffices to support the jury verdict" as to competitive injury. LB3. By contrast, Liggett nowhere contested the "need for recoupment" that was part of Liggett's own case from the start. As Liggett's counsel stated at oral argument, "predation is unlikely in the absence of recoupment." Transcript of Feb. 3, 1992 Oral Argument Before the U.S. Court of Appeals for the Fourth Circuit at 16.

After years spent building a case of competitive injury on its own expert's theory of oligopoly recoupment, this Court should not permit Liggett to go back and question this requirement, hoping to create a conflict arising from Liggett's own inability to prove recoupment in *this case*. Especially in view of Liggett's representations to the Fourth Circuit, where it asserted the need for recoupment, Liggett should not be permitted to "have its cake and eat it too" by basing its case on recoupment and then challenging that requirement before this Court.

²⁴ See generally LRB.

Liggett's effort to create a conflict from the Fourth Circuit's citation of *Matsushita* is equally ineffective. The court quoted and relied upon *Matsushita* for the proposition that predation requires proof of a "reasonable expectation" of recoupment. Pet. App. 9a. Liggett concedes that this is the proper legal standard. Any "conflict" regarding the proper application of *Matsushita* is therefore academic.

E. The Fourth Circuit Did Not Require Proof of Actual Injury to Competition

Liggett's suggestion that the Fourth Circuit imposed a "requirement of actual effects" or "actual injury to consumers" is also specious. Pet. Question Presented No. 3; Pet. 22-23. No such "requirement" appears in the text of the opinions below. Of course both courts recognized that proof of competitive injury under Robinson-Patman is satisfied by a showing "that the effect of [discriminatory] pricing 'may be substantially to lessen competition.'" Pet. App. 7a; *accord id.* at 24a. And both courts examined the real impact on the marketplace of B&W's challenged volume discounts, which intensified competition and dramatically broadened the discount segment. But neither court *required* proof of "actual injury to consumers."

The assessment of the procompetitive impact of B&W's volume discounts was appropriate in a 1989-90 trial of Liggett's treble-damage action based on volume discounts introduced in 1984. It responded directly to Liggett's oligopoly recoupment theory which *assumed* that B&W's larger competitors would not react, but would remain inert while B&W pursued its allegedly predatory price discrimination campaign to "manage" generic prices, thus "slowing" generics' "rate of growth." Pet. 11.

Especially in view of *Eastman Kodak's* requirement that economic theory must conform to "market reality," no basis exists for Liggett's assertion that its theory of oligopoly recoupment, founded on the assumed passivity of all other industry "oligopolists," must be credited "regardless of its accuracy in reflecting the actual market,"

Eastman Kodak, 112 S. Ct. at 2083, and even though that "theory does not explain the actual market behavior revealed in the record." *Id.* at 2085.

It is therefore obvious that no conflict exists between the ruling of the Fourth Circuit, which imposed no "requirement of actual effects" in Robinson-Patman Act cases, with either of the Sherman Act decisions cited by Liggett or with *Henry v. Chloride, Inc.*, 809 F.2d 1334 (8th Cir. 1987), which adopted the same "reasonable possibility" formulation of the primary-line injury requirement.

Moreover, according to *Henry*, even though "predatory intentions need not be accomplished," "economically plausible" predatory pricing presupposes a "reasonable expectation on the part of the alleged predator that it will succeed in dominating, if not controlling, the market"—the very proposition that Liggett failed to establish here. 809 F.2d at 1345 n.9.

Finally, refuting Liggett's assertion that the actual "market reality" after a challenged price discrimination should be ignored, Pet. 22-23, primary-line Robinson-Patman cases have been dismissed precisely because the "reality" of increased competition afterwards negated any "reasonable possibility" of competitive injury at the time.²⁵

F. The Fourth Circuit Did Not Eliminate the "Independent Force" of the Robinson-Patman Act

According to Liggett the Fourth Circuit ruled out liability for oligopoly recoupment under the Robinson-Patman Act, thus rendering the Robinson-Patman provision "redundant of the Sherman Act." Pet. 13. Liggett claims that this contravenes Congressional intent that the 1914 Clayton Act should extend beyond the Sherman Act, thus

²⁵ *E.g.*, *Dean Milk Co. v. Federal Trade Commission*, 395 F.2d 696, 714 (7th Cir. 1968); *Anheuser-Busch, Inc. v. Federal Trade Commission*, 289 F.2d 835, 842 (7th Cir. 1961); *Minneapolis-Honeywell Regulator Co. v. Federal Trade Commission*, 191 F.2d 786, 790 (7th Cir. 1951), *cert. dismissed*, 344 U.S. 206 (1952); *Yale & Towne Mfg. Co.*, 52 F.T.C. 1580, 1595, 1602 (1956).

(according to Liggett) creating conflict with decisions that do not require monopoly or conspiracy in primary-line Robinson-Patman cases.

Liggett hardly benefits from invoking the Clayton Act of 1914, *id.* at 2, to distance itself from what it calls the "much criticized 1936 amendment." *Id.* at 3 n.2. First, the 1914 Act was aimed at monopoly recoupment of predatory losses, which was neither present nor established here:

In its report of the Clayton Bill to the House of Representatives, the House Judiciary Committee made it clear that its primary purpose was to reach the practice of destroying competition in certain sections by lowering prices below cost and thereafter *recouping such losses* at the expense of the general public *when monopoly had been achieved*.

Goodyear Tire & Rubber Co. v. Federal Trade Commission, 101 F.2d 620, 623 (6th Cir.), *cert. denied*, 308 U.S. 557 (1939) (emphasis supplied).

Second, Clayton Act Section 2 of 1914 expressly exempted and immunized *quantity* discounts from its coverage. *E.g.*, *Goodyear*, 101 F.2d at 622-23; P. Areeda & L. Kaplow, *Antitrust Analysis* ¶ 602(b), at 933-34 (4th ed. 1988). Thus Liggett's price discrimination claim, based solely on B&W's quantity discounts, would have been *dismissed* under the very Clayton Act provision on which Liggett now relies.

As for the "independent force of the Robinson-Patman Act," Pet. Questions Presented,

[t]he basic substantive issues raised by the Robinson-Patman Act's concern with primary-line injury to competition and by the Sherman Act's concern with predatory pricing are identical [W]e see nothing that compels a more restrictive substantive interpretation of the Robinson-Patman Act.

. . . .

Nor does the intent of Congress in passing the Clayton Act to go beyond the Sherman Act have any great

significance, given that no one knew what the Sherman Act rule on predatory pricing was or would come to be and that Congress may well have been operating on pessimistic assumptions.

III P. Areeda & D. Turner, *Antitrust Law* ¶ 720c, at 190 (1978).

In any event, since the decision in this case rests on the factual insufficiency of Liggett's assertions of oligopolistic recoupment, the decision here cannot threaten the "independent force" of the Robinson-Patman Act, Pet. Questions Presented, or "invite a complete coalescence" of that Act and the Sherman Act. Pet. 21-22.

II. THIS CASE IS UNIQUE: REVIEW BY THIS COURT WOULD HAVE NO PRECEDENTIAL VALUE

Liggett does not contest the Fourth Circuit's statement that no case of predatory pricing has ever been based on the theory that oligopolists would "simply stand by and refrain" from competing. Pet. App. 11a. Indeed, Liggett's counsel describes Liggett's oligopoly recoupment approach as "unusual." P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 711.2, at 617 (Supp. 1991). Because both the facts of this case and the nature of Liggett's claim are unique, this case provides a particularly unsuitable vehicle for review by this Court.

The claim presented here is unprecedented under the Robinson-Patman Act, and there is no evident reason why similar claims should arise in the future. Liggett's bare assertion that oligopoly predation is "*more* likely to occur than monopoly predation," Pet. 15 (emphasis in original), is little short of bizarre. If this is so, why is there no reported instance of it in more than a half-century of Robinson-Patman jurisprudence?

The failure of oligopoly recoupment to appear previously in the vast body of Robinson-Patman commentary is compelling evidence of its status as an academic curiosity, spun out by talented scholars to give plausibility to

Liggett's "unusual" claim.²⁶ There are no similar cases pending in the federal courts, thus there is no evidence of either confusion or conflict on any issue related to oligopoly recoupment. Accordingly, there is no need for review of such a claim in this Court.

Liggett's strained Robinson-Patman theories are clearly awkward for Liggett itself. Liggett launched this case as a trademark infringement claim to "thwart" B&W's competitive introduction of an item in the black-and-white segment where Liggett held a 97% share. The oligopoly theories came only later, when, according to Liggett's economic theory witness, Liggett's counsel needed a plausible economic theory to "at least withstand summary judgment." SJA79.²⁷ When first approached by counsel, that witness considered that a claim of predation made against a firm with no more than 12% of the relevant market ". . . makes no bloody sense. It makes no sense at all." *Id.*

Liggett's Robinson-Patman claim of "predation" by B&W is especially unusual in that Liggett accounted for almost all black-and-white sales when B&W first announced its own generics. Moreover, Liggett seems a strange choice as a target for predatory attack. Throughout the period in dispute Liggett was wholly owned by Grand Metropolitan plc, a multinational conglomerate with sales exceeding six billion dollars. JA5733-34. Liggett received wholehearted financial support throughout the volume discount war. Grand Met supplied money to

²⁶ A federal question raised by a petitioner may be "of substance" in the sense that, abstractly considered, it may present an intellectually interesting and solid problem. But this Court does not sit to satisfy a scholarly interest in such issues. . . . "Special and important reasons" imply a reach to a problem beyond the academic or the episodic.

Rice v. Sioux City Memorial Park Cemetery, Inc., 349 U.S. 70, 74 (1955) (citations omitted).

²⁷ "SJA" refers to the Supplemental Joint Appendix filed in the Fourth Circuit.

Liggett each time it was requested. JA5468; JA7913-15.²⁸

Finally, perhaps the most remarkable feature of this record is the denial by Liggett's most senior executives of the very foundation of the theory of oligopoly predation advanced by Liggett's counsel and its economic theory witness. *See supra* pp. 11-12. This expert witness insisted that the industry was rife with "tacit collusion," giving rise to "supracompetitive profits" due to "oligopoly." But Liggett's president and other senior officers flatly denied all of it: as far as they were concerned the public had enjoyed "free and open competition" and "competitive" prices and profits. It will be a rare case, indeed, in which the plaintiff's fundamental theory of competitive injury based on pricing conduct is directly contradicted by the *plaintiff's own president and senior officers* with responsibility for pricing.

Should other Robinson-Patman cases involving oligopoly recoupment ever arise, there will be time enough for this Court to correct any errors that may occur in the analyses made by lower courts. Efficiency of judicial administration would seem to require that the lower courts be permitted to reach more settled positions before a need for this Court's guidance would appear.

In sum, oligopoly recoupment, far from being a greater danger than "monopoly predation," as Liggett contends, is an isolated phenomenon if it exists at all. The district court and the Court of Appeals correctly analyzed Liggett's Robinson-Patman claim and ruled only that Liggett's proof was factually insufficient to show competitive injury in this case. No precedential value can attach to yet a third review of the voluminous record compiled here.

CONCLUSION

The Petition for a writ of certiorari should be DENIED.

²⁸ *See supra* p. 24 ("predatory pricing would make little economic sense to a potential predator unless he had (1) greater financial staying power than his rivals . . .").

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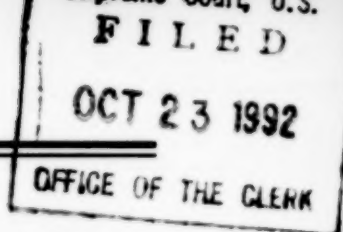
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October 16, 1992



IN THE
Supreme Court of the United States

OCTOBER TERM, 1992

LIGGETT GROUP INC., now named Brooke Group Ltd.,
Petitioner.

VS.

BROWN & WILLIAMSON TOBACCO CORPORATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

REPLY BRIEF FOR PETITIONER

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INTRODUCTION

Respondent B&W's brief in opposition to certiorari rewrites the Fourth Circuit's opinion as narrowly "fact bound" and argues that Liggett's Questions Presented are not before this Court.¹ On that first fundamental point, the Fourth Circuit opinion itself proclaims its general application. Second, B&W's brief does not deny the correctness of the main legal propositions framing the Questions Presented. Third, B&W does not deny the essential facts underlying the verdict, but merely restates factual arguments that the jury rejected in finding that B&W's unjustified below cost pricing was likely to be recouped by supracompetitive prices and had a reasonable possibility of lessening competition.²

¹ Reference is made to Pet. at 1 n.1 for Liggett's statement pursuant to Supreme Court Rule 29.1.

² Contrary to B&W's assertion, the jury could not have found for Liggett "based on an inference of 'predatory intent,' derived exclusively from statements contained in some B&W internal documents." Opp. at 8. In fact, Instruction 11 required proof of a reasonable possibility of injury to competition which was defined by Instruction 12 to mean "injury to consumer welfare." A7940. Although the jury was instructed that a reasonable possibility of injury to competition could be inferred from direct evidence of "predatory intent," both the fact that could be inferred and the fact from which it could be inferred were strictly limited and defined by the instructions. Instruction 12 stated in part:

In order to injure competition in the cigarette market as a whole, Brown & Williamson must be able to create a real possibility of both driving out rivals by loss creating price cutting and then holding on to that advantage to recoup losses by raising and maintaining prices at higher than competitive levels. A7940-41.

Moreover, the jury was told that the only intent relevant to this case is one "in which a company plans to discipline . . . rivals . . . so that it can earn higher than competitive profits. . . ." Instruction 19, A7945-46. Thus, evidence of below-cost pricing and a finding of supracompetitive profits were required before the jury could find competitive injury even by inferring it from "predatory intent."

ARGUMENT

1. While the Fourth Circuit's statement of the case noted facts it thought made its theoretical or legal conclusions more plausible, it laid down a general rule applicable to all industries. That rule -- implicitly rejected in this Court and in other circuits -- is that only an actual or potential monopolist or a conspirator can ever engage in price discrimination that has the potential to harm competition. This rule squarely presents the Question whether the reach of the Robinson-Patman Act is limited to Sherman Act violations.

Without denying that competition had been hurt by an acknowledged (Pet. App. at 6a) narrowing of the discount between generic and branded cigarettes, the court of appeals cited the expansion of the generic segment and observed that "the perfect vision of hindsight confirms our . . . theoretical suspicions." Pet. App. at 12a. The court thus relied on the "actual experience in this case" only to buttress the categorical proposition derived from its own "economic logic." *Id.* at 11a.

The following passages from the Fourth Circuit opinion demonstrate that its opinion was based on the generally applicable legal propositions Liggett attributes to it, not on determinations of controverted facts:

Turning to this case, Liggett has not advanced a theory that Brown & Williamson could ever obtain or maintain monopoly power for any period of time, much less a period sufficient to reap the harvest of its alleged below-cost pricing, since Brown & Williamson never had more than 12% of the agreed-upon market. *Id.* at 10a.

• • •

Liggett's theory therefore amounts to substituting the conscious parallelism of an oligopoly for conspiratorial agreement or actual monopoly power as the reason Brown & Williamson might rationally expect to be able to recoup its investment in disciplining Liggett. *Id.* at 11a.

• • •

[I]n the absence of an agreement among the oligopolists, which nobody contends is the fact in this

case, membership alone in an oligopoly provides no basis for proof of illegal conduct To rely on the characteristics of an oligopoly to assure recoupment of losses from a predatory pricing scheme after one oligopolist has made a competitive move is thus economically irrational. *Id.* at 13a.

The jury verdict for Liggett was overturned not because of an absence of proof,³ but because the Fourth Circuit rejected the legal relevance of the proof on the grounds that a non-monopolist never can be certain of recoupment.⁴ The Fourth Circuit thus relied on its view of economic theory to rule generally that an oligopolist acting alone could not violate the Robinson-Patman Act. Indeed, B&W had asked the Fourth Circuit to do precisely that, arguing that as a matter of theory "[r]ecoupment requires the acquisition and sustained exercise of monopoly power" and that monopoly power requires a "single firm" with at least a "dominant share" of the market. B&W's Fourth Circuit brief at 21, 24-25. Because the

³ The district court noted that the evidence supported the verdict, apart from the court's own post-trial legal rulings, on which the Fourth Circuit did not rely and which are not at issue here:

The court's JNOV ruling on competitive injury, causation, and antitrust injury are based upon interpretations of the applicable law. If these interpretations are found to be erroneous and an appellate court applies legal standards more favorable to Liggett, this court does not believe that an examination of the weight of the evidence, the credibility of witnesses and any alleged errors in the admission or rejection of evidence or instructions to the jury would justify granting B&W a new trial. Pet. App. at 19a.

⁴ B&W argues that the Fourth Circuit required certainty only on the part of "oligopolists on the sidelines," not of the defendant. Opp. at 16 n.20. But the distinction is meaningless: if rivals have to be certain of each others' reaction before refraining from intense price competition, then supracompetitive oligopolistic pricing would never occur.

Fourth Circuit opinion is not fact bound,⁵ it not only presents Liggett's Questions, but also creates the conflicts identified in the Petition.⁶

2. B&W does not deny that the text and legislative history of the Robinson-Patman Act as well as this Court's decisions and proper economic logic provide for liability where there has been unjustified, discriminatory, pricing below average variable cost by a member of an oligopoly who reasonably anticipates that it can recoup its losses by relying on predictable (although not certain) oligopolistic price coordination at supracompetitive levels. While B&W repeatedly describes this as Liggett's theory and as an "academic" possibility, it is in fact B&W's own high-level plan which explained exactly how this single oligopolist could discipline a smaller rival and profit by doing so.

B&W does not deny that the statutory test for primary-line liability is a reasonable possibility of harm to competition at the time the price discrimination is undertaken -- even without conspiracy, monopoly,⁷ or actual success.⁸ Nor does B&W even

⁵ Contrary to B&W's suggestion, Opp. at 17 n.21, the Fourth Circuit did not take the same approach as the district court. The district court refused to rule out predation by an oligopolist as a matter of law. Pet. App. at 34a. The Fourth Circuit did.

⁶ There is a genuine conflict among the circuits upon the need for recoupment. See Pet. at 20-22. Liggett accepted the need for potential recoupment and proved it.

⁷ B&W quotes an occasional judicial sentence speaking of monopoly as the concern of the price-discrimination statute but offers no reason to reject the statutory language or history. Compare Opp. at 27 with Pet. at 14-15.

Contrary to B&W's suggestion, the treatise it cites, Opp. at 27, does not insist that the two statutes should be identical in all respects. Rather, it speaks only of an identical price-cost test under both statutes for distinguishing proper from improper prices. 3 P. Areeda and D. Turner, *Antitrust Law* ¶720c, at 190 (1978); see also P. Areeda and H. Hovenkamp *Antitrust Law* ¶720'c, at 697 (1991 Supp.).

deny the market-place fact that anticompetitive below-cost disciplinary pricing can be profitable to an oligopolist who is neither an actual or prospective monopolist nor a cartel member.

B&W repeatedly suggests that there is some issue with the existence of price discrimination. There is not. The district judge instructed the jury that price discrimination existed. A7934. Because B&W's cross-appeal of the judge's denial of its conditional demand for a new trial did not challenge this ruling, B&W's attempt to raise it here, Opp. at 7 n.10, is procedurally improper as well as factually insupportable.

B&W suggests that volume-based price discrimination cannot harm competition when available in every geographic region. However, this Court and lower courts have held otherwise,⁹ and the Fourth Circuit rested on no such distinction, although B&W contends it did. Opp. at 22. Moreover, the most that price discrimination can do in any case is to facilitate predatory pricing by making it less expensive and by targeting it. Injury to competition is never the "effect" of discrimination directly. Rather it is "the result of a low price which a discrimination in price allowed the defendant to charge." *Shore Gas and Oil Co. v. Humble Oil & Refining Co.*, 224 F. Supp. 922, 925 (D.N.J. 1963).¹⁰

⁸ B&W argues that the Fourth Circuit did not require success. In fact, the Fourth Circuit either required success or, as Liggett maintains, it ruled categorically that an oligopolist never has a reasonable possibility of injuring primary-line competition. Moreover, contrary to B&W's representation, Opp. at 26, the Fourth Circuit never asked, as this Court requires, whether B&W's conduct had a "reasonable possibility" of injuring competition at the time it was undertaken.

⁹ See, e.g., *Utah Pie Co. v. Continental Baking Co.*, 385 U.S. 685, 694-96 (1967) (actionable discrimination included that within a single geographic market); *Holleb & Co. v. Produce Terminal Cold Storage Co.*, 532 F.2d 29, 31, 34 (7th Cir. 1976) (discrimination within Chicago); *Borden Co. v. FTC*, 381 F.2d 175 (5th Cir. 1967).

¹⁰ Although not before this Court, this reasoning also disposes of B&W's allusion to its claim of insufficient "causation." Opp. at 12. On another issue not before this Court, B&W alludes to the district court's

3. While B&W repeats a number of factual claims that it unsuccessfully made to the jury, it does not deny the key facts underlying the jury verdict.

a. B&W does not deny that the cigarette industry is one of the most highly concentrated oligopolies (A7813-15), that brand-name profits are among the highest of any industry (A7006-09, A7896), that they are increasing dramatically notwithstanding falling demand (A7010-11), and that they are protected by high barriers to entry (A7771).¹¹ While commentators recognize that effective supracompetitive pricing is not always possible even in highly concentrated markets, Opp. at 21, none of them suggests that non-competitive oligopoly pricing is a rarity.

b. B&W does not deny that its expert economist admitted that B&W priced its black-and-white cigarettes below average variable cost¹² for 18 months:

ruling that Liggett did not suffer antitrust injury. *Id.* However, B&W's antitrust injury argument merely repeats its contention that no violation occurred. Given a violation, however, rivals injured by predatory or disciplinary pricing suffer antitrust injury.

¹¹ To be sure, Liggett's executives denied that they were aware of any kind of collusion and characterized Liggett's profits as "fair." That businessmen who are not engaged in a conspiracy decline to think of themselves as colluding or gouging the public hardly disproves the evidence that profits in the cigarette industry were at supracompetitive levels. B&W's own economic expert testified that he would not change a conclusion that a market exhibited supracompetitive profits merely because an industry executive testified that profits were fair and reasonable. Transcript at 102:128-29, January 24, 1990. Moreover, when confronted with B&W's below-cost pricing, Liggett's executives naturally considered "competition" -- in the businessman's sense -- more intense. See Pet. at 5 n.9.

¹² B&W suggests that such below-cost pricing is not really below-cost because B&W's high profits on branded-cigarettes meant that its revenues exceeded its costs on its total cigarette sales. Opp. at 5. Far from being an excuse, however, the profits on branded-cigarettes support Liggett's contention, based on B&W's own documents, that B&W earned supracompetitive branded profits worth protecting by

Q. Did B&W price above or below average variable cost in 1984 and 1985?

A. Pre-tax trading profit was negative. Therefore, if you disregard financial consequences other than direct sales revenue [i.e., reduced taxes on brand-name cigarette profits] in what you refer to as price, the answer would be that prices are below average variable cost. A7003.

Nor does B&W deny that its contemporaneous financial statements for black-and-whites showed that B&W had a negative trading profit for the eighteen months from its entry into black-and-whites to the close of general discovery, and that negative trading profits meant B&W's prices were below average variable cost according to B&W's own expert economist.¹³ A6996, A7616-19, A7003.

temporarily pricing black-and-whites below-cost.

¹³ Precisely because B&W engaged in sustained and unjustified below-average-variable cost pricing its conduct cannot be regarded as a normal price war, as B&W repeatedly suggests. *E.g.*, Opp. at 4, 5, 14. Moreover, B&W from the outset intended to, and in fact did, consistently undercut Liggett during the five-stage "price war." B&W cut prices lower whenever a Liggett response came close to B&W's lower net price to wholesalers. A5914-15.

B&W's counsel asserts that "at no time did B&W ever expect, intend or reasonably anticipate that its black-and-white generics would be unprofitable." B&W Opp. at 4-5. But B&W contemporaneously said that it was "not going into it [black-and-whites] with the objective to make a profit." A1710. In any event, the average variable cost test is an objective test, not a subjective test. The "reasonably anticipated" phrase in the average variable cost test is designed to permit an expanding firm, which reasonably anticipates declining manufacturing costs as volume grows, to use those lower anticipated costs, not its current costs, as the basis for its prices. See 3 P. Areeda & D. Turner, *Antitrust Law* ¶715d, at 175 (1978). However, B & W makes no such claim, but instead claims merely that it set its prices lower than it had initially planned. A price-cost test becomes meaningless if the defendant can avoid its reach merely by claiming that it lowered its prices in response to market conditions caused by its own actions.

c. B&W never denies the existence of strong record evidence, both before and after the introduction of Doral,¹⁴ demonstrating that B&W believed it could discipline Liggett by below-cost price discrimination targeted at Liggett's "top 38 accounts" and ultimately "narrow the [discount] gap in generics." A1348, A6130, A6127.¹⁵ B&W wrote that "someone must put a lid on [Liggett] -- if we do -- does someone else need to." A1277.

d. B&W does not deny that it expressly considered whether it could recoup its losses and concluded that it could. B&W anticipated the reactions of fellow oligopolists and calculated that it could save \$350 million of brand-name revenue -- which more than recovered its \$14 million investment in below average variable cost pricing. A1341-45. Contrary to B&W's repeated assertion, its predatory scheme never rested on any expectation "that all other oligopolists . . . would simply stand by and refrain from also selling generics." Opp. at 21, *quoting* Pet. App. at 11a. Liggett itself proved through B&W's own documents that B&W expected, correctly, that the other manufacturers *would* be "quite likely" to "introduce branded generics, develop loyal franchises, and then gradually raise prices over the longer term." A1419-20. All that B&W's scheme assumed of the others was that they would not interfere with its narrowing of the price spread after Liggett capitulated. They did not.

¹⁴ The Fourth Circuit noted as consistent with its "economic logic" a B&W memorandum stating "the earlier concern of expanding the economy segment is no longer tenable, given RJR's recent action [in cutting the price of Doral]." Pet. App. at 5a. But that does not speak to the issue of whether B&W intended to discipline Liggett in order to narrow the price spread between branded and black-and-white cigarettes. Indeed that very document states that the major cigarette manufacturers who enter the discount segment "will attempt to manage prices and profitability upward." A1420. Moreover, in subsequent, post-Doral high-level planning documents, B&W reiterated its intent of "reducing [the] percent difference between generic and full revenue brands." A2405.

¹⁵ Although B&W points to Liggett's assets and those of its parent company, Opp. at 29, B&W does not deny that it correctly predicted that Liggett's parent would not tolerate sustained losses on black-and-white cigarettes and that Liggett would ultimately respond to B&W's below-cost rebates by raising list prices.

e. B&W does not deny that the discount between generic cigarettes and full revenue cigarettes fell from 40% in 1985 to 27% in 1989 -- notwithstanding the growth of the reduced price segment¹⁶ -- and all prices rose. Thus consumers paid more for both generic and branded cigarettes. The post-judgment non-record evidence that B&W adduces to show allegedly competitive conditions today is legally irrelevant. Opp. at 6, 10. It does not bear on the reasonable expectations of B&W in 1984-1985 when it priced below average variable cost. Moreover, B&W's use of non-record evidence is procedurally improper and misleading as to current market conditions.¹⁷

4. In sum, B&W does not deny the possibility of disciplinary predation by a single oligopolist, as proclaimed by its own documents. Nor does it deny facts showing that B&W undertook

¹⁶ B&W argues that any discount of more than 25% is enough to ensure generic success. Opp. at 11 n. 15. Even if this were true, a discount of 40% would cause the generic segment to expand much faster and benefit consumers much more than a discount of 27%. B&W also emphasizes a 50% discount on so-called sub-generics -- introduced by Liggett -- without disclosing that all sub-generics accounted for less than 1% of the cigarette market at the time of trial. *Compare* Opp. at 6 with Pet. at 10 n.15.

¹⁷ B&W's non-record evidence fails to reveal that prices and profits in the cigarette industry have been increasing at record levels in recent years. The very non-record document relied upon by B&W states that cigarette manufacturers "are moving to consolidate the price structure within the price-value segment and reduce the huge amount of discounting and couponing in this area." *Maxwell Consumer Report* (July 1992). "According to the U.S. Labor Department, the tobacco industry's 10% average annual price increases over the past 11 years exceeded those of any other product, including hospital rooms and prescription drugs." Patricia Sellers, *Can He Keep Phillip Morris Growing?* FORTUNE MAGAZINE, April 6, 1992, at 86. Prices for full-revenue cigarettes increased 14.59% from 1990 to 1991. Branded generic prices increased even faster -- 19.32% from 1990 to 1991. (Computed from the *Maxwell Consumer Tobacco Monthly* (January 3, 1992)). Finally, sub-generic brand shares are in decline. *Maxwell Consumer Report* (July 1992).

unjustified discriminatory pricing below its average variable cost with the purpose and effect of disciplining a rival and thereby helping bring about higher market prices, for which its documents take credit. Such facts amply support the jury verdict.

If the Fourth Circuit prevails in ruling that such price discrimination by a single oligopolist never has a reasonable possibility of injuring competition, no plaintiff will ever be able to show a primary-line violation in the absence of monopoly or a cartel. That disciplinary pricing has seldom been litigated merely reflects the difficulties in distinguishing proper from improper pricing. Of course, the Fourth Circuit's view assures that there never will be such litigation -- no matter how clearly the evidence of a genuine threat to competition emerges from sophisticated planning documents and conduct.

B&W suggests that issues presented in this case are unique. They are not. All that is unique here is the clarity with which the defendants own high-level documents make plain that its conduct was predatory and could injure competition. This kind of uniqueness makes the case particularly appropriate for Supreme Court review.

CONCLUSION

For the reasons stated above and in Liggett's Petition, Liggett respectfully re-urges the Court to grant certiorari.

Respectfully submitted,

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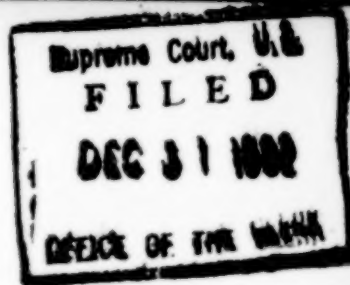
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No. 92-466

In The
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October Term, 1992

LIGGETT GROUP INC.,
now named Brooke Group Ltd.,
Petitioner,
vs.

BROWN & WILLIAMSON
TOBACCO CORPORATION,
Respondent.

On Writ Of Certiorari To The
United States Court Of Appeals
For The Fourth Circuit

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KEY

In this Joint Appendix, brackets indicate text added by counsel to inform the Court of appropriate notations or other information not appearing on the face of the document itself. Where the date of a document has been derived by reference to its accompanying testimony, the citation (Tr. __:__) to such testimony has been included with the document's date.

CHRONOLOGICAL LIST OF
RELEVANT DOCKET ENTRIES
UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA

<u>DATE</u>	<u>FILING OR PROCEEDING</u>
7-2-84	Plaintiff's Complaint filed.
7-17-84	Plaintiff's Verified Supplemental & Amended Complaint with Jury Demand filed.
7-24-84	Answer, Counterclaim & Motion to Strike of Defendant, Striking Allegations in Paragraph 50 of Verified Supplemental & Amended Complaint filed.
7-24-84	Defendant's Motion for Summary Judgment filed.
7-24-84	Defendant's Brief in Support of its Motion for Summary Judgment with attached: Affidavit of Charles G. Lamb. Affidavit of M. Lance Reynolds. Affidavit of Norwood Robinson. Affidavit of T.E. Sandefur, Jr.. Affidavit of J. Kendrick Wolls, III.
8-14-84	Plaintiff's Answer to Defendant's Counterclaim filed.
8-14-84	Plaintiff's Memorandum in Opposition to Defendant's Motion for Summary Judgment with attached: Affidavit of Herbert Pease filed.

- Affidavit of Josiah S. Murray.
Affidavit of E.C. Bryson, Jr.
- 8-21-84 Defendant's Reply Brief to Plaintiff's Memorandum in Opposition to Defendant's Motion for Summary Judgment.
- 8-21-84 Second Affidavit of Charles G. Lamb, in Support of Defendant's Reply Brief to Plaintiff's Memorandum in Opposition to Defendant's Motion for Summary Judgment.
- 8-30-84 Hearing before Magistrate Sharp on Discovery Matters, Defendant's Motion for Summary Judgment, Defendant's Motion for Protective Order & Defendant's Motion to Strike Affidavit.
- 11-30-84 Magistrate's Sharp's Findings and Recommendations: recommended that Defendant's Motion for Summary Judgment be denied, without prejudice to its renewal after first-stage discovery period.
- 2-5-85 Order of Judge Bullock, Pursuant to Magistrate's Findings and Recommendations, that Defendant's Motion for Summary Judgment is denied with respect to all 5 claims in Plaintiff's Supplemental and Amended Complaint, Defendant can renew Motion for Summary Judgment within 60 days at close of Discovery.
- 3-7-85 Answer of Defendant Brown & Williamson to Plaintiff's Second Amended Complaint with Counterclaims against Liggett Group Inc. and Generic Products Corp.
- 3-27-85 Plaintiff Liggett's Reply to Defendant Brown & Williamson Tobacco Corp.'s Answer to Second Amended Complaint & Counterclaims.

- 5-1-85 Counterclaim Defendant Generic Products' Motion to Dismiss for Failure to State a Claim upon which Relief can be Granted, etc.
- 5-1-85 Counterclaim Defendant Generic Products' Memorandum in Support of Motion to Dismiss with attachments including: Affidavit (Unsigned) of Herbert L. Pease, in Support.
- 8-1-86 Plaintiff's Motion for Leave to Amend its Verified Supplemental & Amended Complaint.
- 8-1-86 Plaintiff's Memorandum (Sealed) in Support of Motion for Leave to Amend its Verified Supplemental & Amended Complaint including the Affidavit (sealed) of Philip T. Shannon.
- 9-10-86 Defendant Brown & Williamson's Memorandum (Sealed) in Opposition to Plaintiff's Motion for Leave to Amend its Complaint.
- 10-1-86 Plaintiff Liggett's Reply Brief (Sealed) to Brown & Williamson's Memorandum in Opposition to Liggett's Motion for Leave to Amend its Verified & Amended Complaint.
- 1-2-87 Defendant Brown & Williamson's Motion for Summary Judgment on all claims in the Complaint of Plaintiff Liggett Group, Inc. filed with:
Affidavit (Sealed) of Kenneth G. Elzinga.
Affidavit of Lanny W. Butler.
Affidavit (Sealed) of Lanny W. Butler.
Affidavit (Sealed) of B.E. Bacon.
Affidavit (Sealed) of Roman L. Well.
Affidavit (Sealed) of M. Lance Reynolds.
Appendixes (Sealed).
- 1-2-87 Defendant Brown & Williamson's Memorandum of Law (Sealed) in Support of its Motion

- for Summary Judgment on Liggett's Robinson-Patman Act Claim.
- 1-2-87 Defendant Brown & Williamson's Memorandum of Law (Sealed) in Support of its Motion for Summary Judgment dismissing Liggett's Price Discrimination Claim in its Entirety.
- 1-2-87 Brown & Williamson's Memorandum of Law (Sealed) in Support of its Motion for Summary Judgment on Liggett's Trademark and Unfair Competition Claims.
- 1-5-87 Plaintiff Liggett's Motion for Summary Judgment on its Fifth Cause of Action.
- 1-5-87 Plaintiff Liggett's Memorandum (Sealed) in Support of Motion for Summary Judgment filed with:
Affidavit (Sealed) of William H. Hogeland.
Affidavit (Sealed) of Bruce Topman.
- 1-5-87 Plaintiff Liggett's Motion for Judgment on Defendant Brown & Williamson's Counter-Claims.
- 1-5-87 Plaintiff Liggett's Memorandum (Sealed) in Support of Motion for Summary Judgment on Defendant Brown & Williamson's Counter-Claims filed with the Affidavit (Sealed) of Adam C. Barker.
- 2-2-87 Plaintiff Liggett's Memorandum (Sealed) in Opposition to Defendant Brown & Williamson's Motion for Summary Judgment Dismissing Liggett's Price Discrimination Claim.
Plaintiff Liggett's Memorandum (Sealed) in Opposition to Defendant Brown & Williamson's Motion for Summary Judgment on Liggett's Trademark & Unfair Competition Claims (Sealed).

- 2-2-87 Plaintiff Liggett's Memorandum (Sealed) in Opposition to Defendant Brown & Williamson's Motion for Summary Judgment on Branded Versus Generic Cigarettes.
- 2-2-87 Affidavit (Sealed) of William H. Hogeland, in Opposition to Defendant Brown & Williamson's Motion for Summary Judgment & in Further Support of Plaintiff Liggett's Motion for Summary Judgment.
- 2-2-87 Affidavit (Sealed) of Bruce Topman, in Opposition to Defendant Brown & Williamson's Motion for Summary Judgment & in Further Support of Plaintiff Liggett's Motion for Summary Judgment.
- 2-2-87 Affidavit (Sealed) of Joseph Diamante, in Opposition to Defendant Brown & Williamson's Motion for Summary Judgment on Liggett's Trademark & Unfair Competition Claims.
- 2-2-87 Affidavit (Sealed) of William B. Burnett, in Support of Plaintiff Liggett's Opposition to Defendant Brown & Williamson's Motion for Summary Judgment.
- 2-2-87 Affidavit (Sealed) of Thomas F. Keller, in Support of Plaintiff Liggett's Opposition to Defendant Brown & Williamson's Motion for Summary Judgment.
- 2-2-87 Affidavit (Sealed) of David R. Jackson, in Support of Plaintiff Liggett's Opposition to Defendant Brown & Williamson's Motion for Summary Judgment.

- 2-2-87 Defendant Brown & Williamson's Memorandum (Sealed) in Opposition to Plaintiff Liggett's Motion for Summary Judgment on Liggett's Fifth Cause of Action.
- 2-2-87 Defendant Brown & Williamson's Memorandum (Sealed) in Opposition to Plaintiff Liggett's Motion for Summary Judgment dismissing Brown & Williamson's Counter-Claims.
- 2-2-87 Affidavit (Sealed) of Rachel Pollock in Support of Defendant Brown & Williamson's Opposition to Plaintiff Liggett's Motion for Summary Judgment.
- 2-2-87 Affidavit (Sealed) of Kenneth G. Elzinga, in Support of Defendant Brown & Williamson's Opposition to Plaintiff Liggett's Motion for Summary Judgment.
- 2-19-87 Plaintiff Liggett's Memorandum (Sealed) in Reply to Defendant Brown & Williamson's Memorandum in Opposition to Liggett's Motion for Summary Judgment on its Fifth Cause of Action.
- 2-19-87 Plaintiff Liggett's Reply Memorandum (Sealed) in Support of its Motion for Summary Judgment on Defendant's Counter-Claims.
- 2-19-87 Reply Affidavit (Sealed) of Adam C. Barker, in Support of Plaintiff Liggett's Motion for Summary Judgment on Defendant's Counter-Claims.
- 2-19-87 Affidavit (Sealed) of Garret G. Rasmussen, in Support of Plaintiff Liggett's Motion for Summary Judgment.

- 2-19-87 Reply Affidavit (Sealed) of William H. Hogeland, in Support of Plaintiff Liggett's Motion for Summary Judgment.
- 2-19-87 Reply Affidavit (Sealed) of Kenneth G. Elzinga, filed by Defendant Brown & Williamson in Response to 1-30-87 Affidavit of William B. Burnett.
- 2-20-87 Defendant Brown & Williamson's Reply Memorandum (Sealed) in Support of Motion for Summary Judgment on Liggett's Robinson-Patman Act Claim Regarding Sales of Branded Versus Generic Cigarettes.
- 2-20-87 Defendant Brown & Williamson's Reply Memorandum (Sealed) in Support of Motion for Summary Judgment on Liggett's Trademark & Unfair Competition Claims.
- 2-20-87 Defendant Brown & Williamson's Reply Memorandum (Sealed) in Support of Motion for Summary Judgment dismissing Liggett's Price Discrimination Claim in its Entirety.
- 3-25-87 Affidavit (Sealed) of Martin Flumenbaum, in Support of Defendant Brown & Williamson's Motion for Summary Judgment Dismissing in its Entirety Price Discrimination Claim of Plaintiff.

- 4-16-87 Notice of Oral Argument on Dispositive Motions at 9:30 a.m. May 12, 1987 in Greensboro.
- 5-11-87 Supplemental Affidavit (Sealed) of William H. Hogeland, submitted by Plaintiff Liggett in Support of their Motions for Summary Judgment & in Opposition to Brown & Williamson's Motions for Summary Judgment.
- 5-12-87 Hearing before Magistrate Sharp on Dispositive Motions. Hearing continued throughout the day. Hearing to be continued to a date to be set. Transcript to be sealed when filed.
- 5-12-87 Deposition (Copy) (Sealed) of William B. Burnett, filed by Defendant Brown & Williamson in Support of Dispositive Motions.
- 5-15-87 Notice of Oral Argument on Dispositive Motions at 9:30 a.m. on June 3, 1987 (continued from May 12, 1987).
- 5-22-87 Affidavit (Sealed) of Harold A. Grant, in Support of Plaintiff Liggett's Motion for Summary Judgment in Opposition to Defendant Brown & Williamson's Motion for Summary Judgment.
- 5-22-87 Affidavit (Sealed) of K.v.R. Dey, Jr., in Support of Plaintiff Liggett's Motion for Summary Judgment and in Opposition to Defendant

- Brown & Williamson's Motion for Summary Judgment.
- 6-3-87 Hearing before Magistrate Sharp in Greensboro. Plaintiff's Motion for Summary Judgment on Defendant's Counterclaim is heard and taken under consideration. Plaintiff's Motion for Summary Judgment on Defendant's Counterclaim is heard and taken under consideration. Plaintiff's Motion to Admit Affidavit's of Dey and Grant are taken into consideration (Oral Motion) Defendant GPC Motion to Dismiss is taken under consideration.
- 12-15-87 Findings & Recommendations of Magistrate Sharp, Brown & Williamson's Motion for Summary Judgment on Liggett's Trademark & Unfair Competition Claims Denied except as Liggett requests legal relief with respect to Brown & Williamson's use of infringing Leaf Design mark; Liggett's Motion to Amend to add further Trademark & Unfair Competition Claims Denied; Brown & Williamson's Motion for Summary Judgment on Liggett's Robinson-Patman Claim as to Branded v. Generic Granted; Brown & Williamson's Motion for Summary Judgment on Liggett's Robinson-Patman Claim as to Generic v. Generic Denied; Liggett's Motion for Summary Judgment on its Robinson-Patman Claims Denied; Liggett's Motion for Summary Judgment on Brown & Williamson's Counterclaims Granted; Generic Products' Motion to Dismiss Granted; that Objections to these Recommendations shall be filed within (40) days and Responses shall be filed with (20) days.

- 1-25-88 Defendant Brown & Williamson's Objections (Sealed) to Magistrate's Findings and Recommendations.
- 1-25-88 Defendant Brown & Williamson's Request for Hearing with respect to its Objections.
- 1-25-88 Defendant Brown & Williamson's Motion for Reconsideration of Magistrate's Findings and Recommendations.
- 1-25-88 Defendant Brown & Williamson's Memorandum (Sealed) in support of Motion for Reconsideration.
- 1-25-88 Plaintiff Liggett's Objections (Sealed) to Magistrate's Findings and Recommendations.
- 2-8-88 Generic Products' Response - to Magistrate's Findings and Recommendations.
- 2-16-88 Defendant Brown & Williamson's Memorandum of Law in Opposition to Liggett's Objections to Magistrate's Findings and Recommendations.
- 2-16-88 Plaintiff's Memorandum of Law in Opposition to Brown & Williamson's Motion for Reconsideration of & Objections to Magistrate's Findings and Recommendations (Sealed) filed with: Supplemental Affidavit of William H. Hogeland (Sealed).
- 3-7-88 Defendant Brown & Williamson's Reply Memorandum to Liggett's Opposition to Motion for Reconsideration.
- 3-9-88 Order of Magistrate Sharp, that Defendant Brown & Williamson's Motion for Reconsideration is Denied.

- 9-30-88 Order of Judge Bullock, adopting Magistrate's Findings and Recommendations as set out; trial on remaining issues will be scheduled for Spring 1989.
- 10-21-88 Defendant Brown & Williamson's Motion for Permission to Appeal to add to Court's Order of September 30, 1988 the statement required by 28 U. S. C. § 1292(b) to Certify Order for Interlocutory Appeal.
- 10-21-88 Defendant Brown & Williamson's Memorandum in Support of Motion for Permission to Appeal.
- 11-9-88 Plaintiff Liggett's Memorandum in Opposition to Brown & Williamson's Motion to Modify Court's Order of September 30, 1988.
- 3-17-89 Order of Judge Bullock, Defendant's Motion for Permission to Appeal Pursuant to 28 U. S. C. 1292(b) must be Denied.
- 4-7-89 Defendant Brown & Williamson's Motion to Join Grand Metropolitan, Inc. as Additional Party Plaintiff.
- 4-7-89 Defendant Brown & Williamson's Memorandum in Support of Motion to Join Additional Party Plaintiff filed with: Affidavit of Norwood Robinson.
- 4-28-89 Plaintiff Liggett's Memorandum (Sealed) in Opposition to Defendant Brown & Williamson's Motion to Join an Additional Party Plaintiff filed with: Affidavit of Josiah S. Murray, III.

- 5-2-89 Grand Metropolitan's Memorandum in Opposition to Defendant Brown & Williamson's Motion to Join Metropolitan as Additional Party Plaintiff filed with: Affidavit of Joel H. Gross.
- 5-15-89 Defendant Brown & Williamson's Reply Brief to Plaintiff Liggett's & Grand Metropolitan's Opposition to Defendant Brown & Williamson's Motion to Join Grand Metropolitan as Additional Party Plaintiff.
- 6-7-89 Motion Hearing & Final Pre-Trial Conference before Judge Bullock in Greensboro: Defendant's Motion to Bring Grand Metropolitan into Case Denied.
- 6-28-89 Defendant Brown & Williamson's Requested *Voir Dire* Questions.
- 7-6-89 Plaintiff Liggett's Proposed *Voir Dire* Questions.
- 7-7-89 Defendant's Motion to Strike Jury and Request that Case be Tried by the Court filed.

- 7-10-89 Jury Trial before Judge Bullock, (1st day) Defendant's Motion to Strike Jury (filed July 7, 1989) - Denied. Jury of 6 & 4 alternates Selected & Excluded until July 11, 1989, 9:30 a.m. Court directed counsel to submit jury instructions by July 27, 1989.
- 7-17-89 Plaintiff's Memorandum in Support of Proposed Preliminary Jury Instruct with Proposed Supplemental Instructions attached.
- 7-17-89 Defendant's Proposed Preliminary Antitrust Jury Instructions filed.
- 7-26-89 Defendant's Proposed Jury Instructions filed.
- 7-26-89 Plaintiff's Preliminary Proposed Jury Instructions on Liability Issues filed.
- 11-13-89 Defendant's Memorandum in Support of Motion for Directed Verdict dismissing Liggett's Antitrust Claim.
- 1-14-89 Hearing before Judge Bullock on Defendant's Motion Pursuant to Rule 50 of the Federal Rules of Civil Procedure; taken under advisement.
- 1-15-89 Plaintiff's Memorandum establishing its Robinson-Patman Act Claim filed.
- 1-30-90 Defendant's Proposed Antitrust Jury Instructions filed.
- 2-2-90 Jury trial resumed. (105th day) defendant rested; plaintiff made Motion for Directed Verdict as to Price Discrimination; Functional Availability; Meeting Competition; and Below

- Average Variable Costs; taken under Advice-ment.
- 2-2-90 Plaintiff's Motion for a Directed Verdict in its Favor on the Issue of Below-Average Variable-Cost Pricing filed.
- 2-8-90 Hearing before Judge Bullock on Charge and Document Discussion. Defendant made Motion; for Directed Verdict and plaintiff renewed Motion for Directed Verdict; both taken under advisement.
- 2-12-90 Hearing before Judge Bullock on Charge. Defendant's Motion for Mistrial denied.
- 2-23-90 Plaintiff's Proposed Jury Instructions filed in letter form.
- 3-2-90 Jury trial resumed. (120th day) Jury deliberations resumed at 9:00 a.m. Jury returned with verdict for plaintiff at 11:16 a.m. Plaintiff to submit Proposed Judgment and Motion on Prejudgment Interest.
- 3-20-90 Judgment of Judge Bullock, that Plaintiff Liggett Have & Recover of defendant Brown & Williamson sum of \$148,800,000.00 which represents \$49,600,000.00 trebled pursuant to 15 U. S. C. § 15(a); Plaintiff Liggett Have & Recover of defendant Brown & Williamson Post-Judgment Interest from Date of Entry of this Judgment; Plaintiff Liggett Have & Recover of defendant Brown & Williamson its Cost of Suit, including reasonable attorney's fee, amount of which shall be determined in later collateral proceeding before this Court.
- 4-2-90 Defendant Brown & Williamson's Motion for Judgment Notwithstanding Verdict or, in alternative, a new trial filed.

- 4-2-90 Defendant Brown & Williamson's Memorandum in Support of Motion for Judgment Notwithstanding, etc.
- 4-2-90 Defendant Brown & Williamson's Motion for New Trial Based on Trial Publicity [Sealed]
- 4-2-90 Defendant Brown & Williamson's Memorandum [Sealed] in Support of Motion for New Trial filed with:
Affidavit [Sealed] of Ralph Simpson.
Affidavit [Sealed] of Patrick Stone.
Affidavit [Sealed] of Patrick Stone.
Affidavit [Sealed] of Valerie Oates.
- 4-2-90 Plaintiff's Motion for New Trial on counts I-IV of Complaint filed.
- 4-2-90 Plaintiff's Memorandum in Support of Motion for New Trial, etc.
- 4-3-90 Plaintiff Liggett's Motion for Prejudgment Interest filed.
- 4-3-90 Plaintiff Liggett's Memorandum in Support of Motion for Prejudgment Interest.
- 4-20-90 Defendant Brown & Williamson's Memorandum in Opposition to plaintiff Liggett's Motion for New Trial on Trademark Counts (I-IV) of Co.
- 4-20-90 Defendant Brown & Williamson's Memorandum in response to plaintiff Liggett's Motion for Prejudgment Interest.

- 4-20-90 Plaintiff Liggett's Memorandum [Sealed] in Opposition to defendant Brown & Williamson's Motion for New Trial based on Trial Publicity.
- 4-20-90 Plaintiff Liggett's Memorandum in Opposition to defendant Brown & Williamson's Motion for Judgment Notwithstanding Verdict or for New Trial filed.
- 4-24-90 Motions Hearing before Judge Bullock: Defendant's for New Trial based on Trial Publicity; Defendant's for Judgment Notwithstanding Verdict or in Alternative, a New Trial; Plaintiff's for New Trial based on Trademark.
- 5-4-90 Plaintiff Liggett's Reply Memorandum in Support of its Motion for New Trial on Counts I-IV of Complaint.
- 5-4-90 Plaintiff Liggett's Reply to defendant Brown & Williamson's Memorandum in Response to Liggett's Motion for Prejudgment Interest.
- 5-4-90 Defendant Brown & Williamson's Reply Memorandum in Support of its Motion for Judgment Notwithstanding Verdict or for New Trial.
- 8-27-90 Memorandum Opinion of Judge Bullock.
- 8-27-90 Order & Judgment of Judge Bullock; Defendant's Motion for Judgment Notwithstanding Verdict is Granted & Jury Verdict & Judgment in favor of Plaintiff is set aside & Judgment entered for defendant; Defendant's Motion for a New Trial is Denied; Plaintiff's Motion for a New Trial is Denied.

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

<u>DATE</u>	<u>FILING OR PROCEEDINGS</u>
9-24-90	Plaintiff's Notice of Appeal filed.
9-28-90	Defendant's Notice of Appeal filed.
10-2-90	Docketing statement filed by Appellant Liggett Group Inc.
10-2-90	Disclosure statement filed by Appellant Liggett Group Inc.
10-3-90	Civil case docketed.
10-4-90	Docketing notice issued.
10-11-90	Clerk order filed consolidating case(s) 90-1851 (Liggett's main appeal) with 90-1854 (Cross-appeal by Brown & Williamson against Liggett Group, Inc.).
10-11-90	Docketing notice issued (cross-appeal).
10-15-90	Disclosure statement filed by Appellee Brown & Williamson
1-14-91	Addendum to docketing statement filed by Appellant Liggett Group Inc.
7-23-91	Page-proof cross-appeal brief filed by Appellant Liggett Group Inc.
7-25-91	Designation of appendix filed by Appellant Liggett Group Inc.
8-29-91	Page-proof cross-appeal brief filed by Appellee Brown & Williamson.
8-30-91	Designation of appendix filed by Brown & Williamson.
9-30-91	Page-proof reply brief filed by Liggett Group Inc.

- 9-30-91 Designation of supplemental appendix filed by appellant Liggett Group Inc.
- 10-10-91 Joint appendix filed.
- 10-16-91 Supplemental appendix filed.
- 10-17-91 Protective Notice of Appeal filed by Brown & Williamson (supplemental appeal).
- 10-18-91 Final form of cross-appeal brief filed by Appellant Liggett Group Inc.
- 10-18-91 Final form of reply brief filed by Appellant Liggett Group Inc.
- 10-22-91 Final form of cross-appeal brief filed by Brown & Williamson.
- 10-22-91 Final form of reply brief filed by Appellee Brown & Williamson.
- 10-24-91 Supplemental briefing order filed. Projected Calendar: February 1992.
- 10-24-91 Corrected order filed setting forth supplemental briefing and consolidating case 91-1221 (Brown & Williamson's supplemental appeal) with 90-1851 (Liggett's appeal) and 90-1854 (Brown & Williamson's cross-appeal).
- 10-25-91 Docketing notice issued on supplemental appeal.
- 10-28-91 Docketing statement filed by Appellant Brown & Williamson in its supplemental appeal.
- 11-4-91 Designation of appendix filed by Appellee Brown & Williamson in its supplemental appeal.
- 12-3-91 Supplement brief filed by Appellant Brown & Williamson.

- 12-3-91 Supplement appendix filed.
 - 12-20-91 Supplemental brief filed by Appellee Liggett Group Inc.
 - 1-3-92 Case calendared for oral argument.
 - 2-3-92 Oral argument heard.
 - 5-11-92 Published, authored opinion filed.
 - 5-11-92 Judgment Order filed. Terminated on the Merits after Oral Hearing.
 - 5-26-92 Petition filed by Appellant Liggett Group Inc. for rehearing with suggestion for rehearing *in banc*.
 - 6-9-92 Supplemental authorities filed by Appellant Liggett Group Inc.
 - 6-18-92 Court Order filed denying motion for rehearing and motion for suggestion for rehearing *in banc*.
-

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

LIGGETT GROUP INC.)	
Plaintiff)	
v.	)	Civil Action No.
	)	C-84-617-D
BROWN & WILLIAMSON	)	(Filed July 24, 1984)
TOBACCO CORPORATION)	
Defendant)	
)	

AFFIDAVIT

T. E. Sandefur, Jr., being first duly sworn, hereby states the following:

1. My name is T. E. Sandefur, Jr. I am Executive Vice President of Brown & Williamson Tobacco Corporation ("B & W"). Prior to joining B & W, I was employed by the R. J. Reynolds Tobacco Company from 1964 until 1982 in various sales and marketing positions. Because of my twenty years of direct experience in the promotion and advertising of cigarettes. I am familiar with all aspects of the marketing of cigarette products and with the highly competitive nature of the United States cigarette industry.

2. B & W manufactures and distributes KOOL, VICEROY, RALEIGH, BELAIR, BARCLAY and RICHLAND cigarettes, and non-cigarette products including SIR WALTER RALEIGH pipe tobacco and various brands of snuff, plug and chewing tobacco. B & W processes

tobacco leaf in facilities located at Wilson, North Carolina and manufactures tobacco products in North Carolina, Virginia, and Georgia.

3. B & W currently accounts for approximately 11.4% of the total cigarette market in the United States by volume of cigarettes produced. Two larger cigarette manufacturers, R. J. Reynolds Tobacco Company and Philip Morris, Inc. currently account for approximately 29.8% and 36.2% of that market respectively. The three other major cigarette manufacturers include the Plaintiff herein, Liggett Group Inc., with an approximate current market share of 5.9%, the American Tobacco Company with a current approximate market share of 8.2% and Lorillard with a current approximate market share of 8.4%.

4. Since early 1975, when B & W's market share was approximately 17.2%, B & W's market share has continually declined to its current 11.4%. To reverse this decline, B & W has over the last several years introduced several new cigarette brands such as BARCLAY, RICHLAND, FACT and ARTIC LIGHTS and has expanded its established brand lines into new market segments such as low-tars and ultra-low tars, and is currently attempting to introduce a line of generic (unbranded) cigarettes.

5. In recent years, there has been an enormous increase in the marketing of generic products. Generic products are marketed in black and white packages and the manufacturer makes no effort to create brand identity. Further, because of the use of generic packaging and the lack of advertising and other name promotion expenses, the price of generic products is less than branded, nationally advertised products with savings being passed on to

the consumer. The growth of the generic market in all areas is directly attributable to the lack of consumer concern for the point of origin or brand identification and the presence of an overwhelming concern for price. The manufacturer of generic products, in effect, represents to the consumer that the consumer is not paying for the customary advertising or other costs to promote the source of production or name. Liggett has repeatedly referred to its generic cigarettes as being "no name" and does not identify itself in any fashion on its generic cigarettes, packages or cartons as the manufacturer.

6. In 1980, total generic sales accounted for 230 million cigarettes.

7. In 1983, generic cigarettes achieved sales of over 17.5 billion cigarettes. Liggett now controls about 97% of that market.

8. Generics continue to grow. B & W expects the market to achieve sales of over 30 billion cigarettes in 1984. B & W expects the generics cigarette market to grow continually in the foreseeable future.

9. B & W's losses to generic cigarette products are disproportionately high when compared to losses by B & W's competitors. Stated another way, smokers of B & W's brands are switching to the less expensive generic products at a higher rate than smokers of competitive brands are switching to the generic products. B & W's losses to generics are about 70 percent higher than would be expected based on B & W's market share. B & W projects that by 1988, B & W's losses to generics could total 18 billion cigarettes annually.

10. In early 1984, B & W determined that it would enter the generic portion of the "economy" market.

11. B & W entered this market to regain some of the business which it had lost to generic products since 1980, to reduce any further deterioration in B & W's sales attributable to the growing generic market, and to compete effectively for a share of the market.

12. B & W is convinced that it is able to offer a highly competitive program featuring quality cigarette products that will for the first time give wholesalers and retailers the ability to choose between two competing suppliers of generics. Until now, as a practical matter, the vast majority of wholesalers and retailers who desired to purchase generic products for resale had to buy from Liggett (or from a Liggett-controlled broker/distributor network). Liggett was the sole nationwide manufacturer of such products until B & W announced its program.

13. B & W did not intend to copy any Liggett package design or trade dress. B & W was simply designing packages that would fit into the well-recognized category of generic "black and white" packaging that is found in many lines of commerce

* * *

[Handwritten Note]
[1/30/90]

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

-----x	:	
LIGGETT GROUP INC.,	:	Civil Action
Plaintiff,	:	No. C-84-617-D
- against -	:	
BROWN & WILLIAMSON	:	
TOBACCO CORPORATION,	:	
Defendant.	:	
-----x	:	

BROWN & WILLIAMSON'S
PROPOSED ANTITRUST JURY INSTRUCTIONS

Brown & Williamson submits the attached as its proposed jury instructions on the antitrust issues in this case. Brown & Williamson reserves the right to modify, withdraw or supplement these instructions.

Dated: January 30, 1990

PAUL, WEISS, RIFKIND, WHARTON
& GARRISON

By: /s/ Martin London
Martin London
Nathaniel B. Smith

- temporarily -

119 N. Greene Street, 2nd Floor
Greensboro, North Carolina 27401
(919) 574-0444

- and -

PETREE STOCKTON & ROBINSON

By: /s/ Norwood Robinson
Norwood Robinson
Michael L. Robinson

1001 West Fourth Street
Winston-Salem, North Carolina 27101

Attorneys for Defendant
Brown & Williamson Tobacco
Corporation

* * *

INSTRUCTION NO. 19

In determining whether prices are predatory, you must look at what the seller reasonably believed its costs and revenues would be. Brown & Williamson's conduct would not be predatory if it reasonably believed that its revenues would be sufficient to cover its average variable costs. If you find that Brown & Williamson reasonably believed its revenues would exceed its average variable costs, you must find that it did not engage in predatory pricing. Thus, if you find that at the time it set its rebates and prices it expected to make money, then you must find that Brown & Williamson is not liable. Furthermore, if you find that Brown & Williamson reasonably believed that its costs would not exceed its revenues, but that because it had to spend unanticipated money in response to competitive activity later on after it entered the value-for-money segment its costs did exceed its revenues, then you must find for Brown & Williamson on the Robinson-Patman Act claim.

Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 233-36 (1st Cir. 1983); *MCI Communications Corp. v. AT&T*,

708 F.2d 1081, 1119-22 (7th Cir.), *cert. denied*, 464 U.S. 891, 104 S. Ct. 234, 78 L. Ed. 2d 226 (1983); *International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d 714, 723-24 (5th Cir. 1975), *cert. denied*, 424 U.S. 943, 96 S. Ct. 1411, 47 L. Ed. 2d 349 (1976); *ILC Peripherals Leasing Corp. v. IBM*, 458 F. Supp. 423, 432-34 (N.D. Cal. 1978), *aff'd*, 636 F.2d 1188 (9th Cir. 1980), *cert. denied*, 452 U.S. 972, 101 S. Ct. 3126, 69 L. Ed. 2d 983 (1981); *Ill P. Areeda & D. Turner, Antitrust Law*, § 715 & § 711d (1978).

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

LIGGETT GROUP, INC.,)	
)	
Plaintiff,	)	CIVIL NO.
	)	C-84-617-D
v.)	
BROWN & WILLIAMSON	)	(Filed
TOBACCO CORPORATION,	)	March 2, 1990)
)	
Defendant.)	

ISSUES

WE, the jury in the above-entitled civil action, do answer the issues as follows:

1. Did Brown & Williamson engage in price discrimination that had a reasonable possibility of injuring competition in the cigarette market as a whole in the United States?

Yes [Handwritten]
(Yes or No)

2. If so, did Liggett Group, Inc., suffer injury to its business or property as a result of such price discrimination?

Yes [Handwritten]
(Yes or No)

3. Did Brown & Williamson engage in price discrimination in good faith with the intention to meet, but not beat, the equally low net prices of Liggett Group, Inc.?

No [Handwritten]
(Yes or No)

4. What amount of damages, if any, is Liggett Group, Inc., entitled to recover from Brown & Williamson as a result of Brown & Williamson's violation of the Robinson-Patman Act?

(Do not consider this issue unless you have answered "Yes" to both Issues 1 and 2, and "No" to Issue 3.)

\$49.6 million [Handwritten]

(Amount)

5. Did Brown & Williamson violate the United States Trademark Act by infringing Liggett Group, Inc.'s quality seal trademark?

No [Handwritten]
(Yes or No)

6. Did Brown & Williamson violate the North Carolina common law of trademarks by infringing Liggett Group, Inc.'s quality seal trademark?

No [Handwritten]
(Yes or No)

7. Did Brown & Williamson violate the North Carolina common law of unfair competition by infringing Liggett Group, Inc.'s quality seal trademark?

No [Handwritten]
(Yes or No)

8. Did Brown & Williamson intend to infringe Liggett Group, Inc.'s quality seal trademark?

No [Handwritten]
(Yes or No)

9. Were consumers actually confused by Brown & Williamson's infringement of Liggett Group, Inc.'s quality seal trademark?

No [Handwritten]
(Yes or No)

10. What amount, if any, is Liggett Group, Inc., entitled to recover from Brown & Williamson as compensatory damages for Brown & Williamson's infringement of Liggett Group, Inc.'s quality seal trademark?

\$ -0- [Handwritten]
(Amount)

11. What amount, if any, is Liggett Group, Inc., entitled to recover from Brown & Williamson as punitive damages for violation of the North Carolina common law of trademarks or unfair competition?

(Do not consider this issue unless you have answered Issue 6 or 7 "Yes" and have awarded compensatory damages in Issue 10.)

\$ -0- [Handwritten]
(Amount)

SO SAY WE ALL.

/s/ Rocky Alan Phillips
Foreperson of the Jury

[Handwritten]
March 2, 1990

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

LIGGETT GROUP, INC.,)	
Plaintiff,	)	CIVIL NO.
	)	C-84-617-D
v.	)	(Filed March 20, 1990)
BROWN & WILLIAMSON)	
TOBACCO CORPORATION,)	
Defendant.)	

JUDGMENT

This civil action came on for trial before the court and a jury during the session of court beginning July 10, 1989, and the issues having been duly tried and answered by the jury as follows:

1. Did Brown & Williamson engage in price discrimination that had a reasonable possibility of injuring competition in the cigarette market as a whole in the United States?

Yes
(Yes or No)

2. If so, did Liggett Group, Inc., suffer injury to its business or property as a result of such price discrimination?

Yes
(Yes or No)

3. Did Brown & Williamson engage in price discrimination in good faith with the intention to meet, but not beat, the equally low net prices of Liggett Group, Inc.?

No
(Yes or No)

4. What amount of damages, if any, is Liggett Group, Inc., entitled to recover from Brown & Williamson as a result of Brown & Williamson's violation of the Robinson-Patman Act?

(Do not consider this issue unless you have answered "Yes" to both Issues 1 and 2, and "No" to Issue 3.)

\$49,600,000.00
(Amount)

5. Did Brown & Williamson violate the United States Trademark Act by infringing Liggett Group, Inc.'s quality seal trademark?

No
(Yes or No)

6. Did Brown & Williamson violate the North Carolina common law of trademarks by infringing Liggett Group, Inc.'s quality seal trademark?

No
(Yes or No)

7. Did Brown & Williamson violate the North Carolina common law of unfair competition by infringing Liggett Group, Inc.'s quality seal trademark?

No
(Yes or No)

8. Did Brown & Williamson intend to infringe Liggett Group, Inc.'s quality seal trademark?

No
(Yes or No)

9. Were consumers actually confused by Brown & Williamson's infringement of Liggett Group, Inc.'s quality seal trademark?

No
(Yes or No)

10. What amount, if any, is Liggett Group, Inc., entitled to recover from Brown & Williamson as compensatory damages for Brown & Williamson's infringement of Liggett Group, Inc.'s quality seal trademark?

\$0.00
(Amount)

11. What amount, if any, is Liggett Group, Inc., entitled to recover from Brown & Williamson as punitive damages for violation of the North Carolina common law of trademarks or unfair competition?

(Do not consider this issue unless you have answered Issue 6 or 7 "Yes" and have awarded compensatory damages in Issue 10.)

\$
(Amount)

NOW, THEREFORE, IT IS ORDERED AND ADJUDGED that Plaintiff Liggett Group, Inc., have and recover of Defendant Brown & Williamson Tobacco Corporation the sum of ONE HUNDRED FORTY-EIGHT MILLION EIGHT HUNDRED THOUSAND DOLLARS

(\$148,800,000.00), which represents Forty-Nine Million Six Hundred Thousand (\$49,600,000.00) trebled pursuant to 15 U.S.C. § 15(a); and

IT IS FURTHER ORDERED AND ADJUDGED that Plaintiff Liggett Group, Inc., have and recover of Defendant Brown & Williamson Tobacco Corporation post-judgment interest from the date of entry of this judgment, as provided by law under 28 U.S.C. § 1961(a); and

IT IS FURTHER ORDERED AND ADJUDGED that Plaintiff Liggett Group, Inc., have and recover of Defendant Brown & Williamson Tobacco Corporation its cost of suit, including a reasonable attorney's fee, as provided by law under 15 U.S.C. § 15(a), the amount of which shall be determined in a later collateral proceeding before this court.

/s/ Frank W. Bullock, Jr.
United States District Judge

[Handwritten]
March 20, 1990

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

LIGGETT GROUP, INC.,)	
Plaintiff,	)	CIVIL NO.
	)	C-84-617-D
v.	)	(Filed Aug 27, 1990)
BROWN & WILLIAMSON)	
TOBACCO CORPORATION,)	
Defendant.)	

ORDER and JUDGMENT

BULLOCK, District Judge

For the reasons set forth in a memorandum opinion filed contemporaneously herewith,

IT IS ORDERED AND ADJUDGED that Defendant's motion for judgment notwithstanding the verdict pursuant to Rule 50(b), Federal Rules of Civil Procedure, be, and the same hereby is, **GRANTED**, and that the jury verdict and judgment in favor of the Plaintiff be, and the same hereby is **SET ASIDE**, and judgment entered for the Defendant; and

IT IS FURTHER ORDERED that Defendant's alternative motion for a new trial pursuant to Rule 59, Federal Rules of Civil Procedure, be, and the same hereby is, **DENIED**; and

IT IS FURTHER ORDERED that Plaintiff's motion for a new trial pursuant to Rule 59, Federal Rules of Civil Procedure, be, and the same hereby is, **DENIED**.

/s/ Frank W. Bullock
United States District Judge

[Handwritten]
August 27, 1990

TheirsOursTheirsOursTheirsOursTheirsOurs

[Illegible]

A.L. (AL) Cagney
National Sales Manager
Private Label and Generics

August 11, 1981

TO: Jim Dowd

FROM: Al Cagney

SUBJECT: FRANCHISE DISTRIBUTION REPORT
NSM-053

A month or so ago a letter was sent to all Generic Region Managers with a request for their feedback and recommendations pertaining to the above subject class of Gary Tobacco sales.

Please find attached copies of those reports submitted by the Region Managers.

Summarizing the results of their reports is a vast task. You will note that some managers state that ineffective and distributors [sic], with little interest should be dropped immediately from the program. Other managers state lets see what happens during the 3rd and present calendar quarter before making any decisions.

In summary, I recommend the following:

1. During the month of September a final decision be made regarding the Franchise Distributor Program which would be effective *October 1, 1981*.
2. That the accounts that don't have the correct type of retail outlets (large carton type outlets), and/or the correct attitude be dropped from the program. The accounts to be dropped will be given the option of switching to G.P.C. or Class A. Notified in writing.

3. The firms that remain on the program will:

- A. Will receive a rebate payment of \$3.00 per case for all purchases over 100 cases for said quarter. \$6.00 per case for all purchases over 250 cases and \$7.80 per case for all purchases over 500 cases.
- B. That Gary Tobacco Company supply *Free* all display and point of sale material to distributors that sell a minimum of 250 cases per quarter.
- C. Minimum Shipments be dropped from 25 cases to 15 cases delivery point, and the order department is to see that this followed. And only the authorized accounts can purchase these brands.

I realize that some of these recommendations seem harsh and favor the larger more successful distributor, but that is my intent.

Thank you.

/s/ [Illegible]

AJC:ca

Attachment

COMPETITIVE POSSIBILITIES:
RESPONSES AND LIABILITIES
GENERIC/PRIVATE LABEL CIGARETTES

APRIL 23, 1982

* * *

MAJOR TOBACCO COMPANY ENTERS MARKET:

RESPONSE LIABILITIES

DEVELOP BRAND FOR DISTRIBUTOR TRADE (I.C.C.)

- UTILIZE L&M SALES FORCE
 - NO DIRECT COST EFFECTS
 - LOWER PRODUCTIVITY ON NATIONAL BRANDS
 - INSTITUTE "GUARANTEED" SALE "TEST"
 - OFFER PROGRAM ONLY TO DISTRIBUTOR TRADE AS A "TEST"
 - GUARANTEED SALE
 - ESTIMATED 2 1/2% RETURNED GOODS.
1983 VOLUME ESTIMATE = 547,200M UNITS
 - LIABILITY FOR 2 1/2% RETURNS = 13,680M
 - ESTIMATED LIABILITY: \$95,760
 - INCREASE EXISTING REBATE
 - CURRENTLY OFFERING \$6 PER CASE REBATE QUARTERLY TO ALL DISTRIBUTORS
 - INCREASE TO \$9 PER CASE QUARTERLY FOR ALL
 - SUPPLEMENT ADDITIONAL \$5 PER CASE FOR THOSE WHO SELL OVER 500 CASES QUARTERLY
 - ESTIMATED ADDITIONAL LIABILITY, BASED ON 1983 VOLUME ESTIMATE: \$260,400
-

B & W
[LOGO]

BROWN & WILLIAMSON TOBACCO CORPORATION
DOMESTIC COMPETITIVE ANALYSIS
1983 UPDATE

RESTRICTED

MAY 1983

* * *

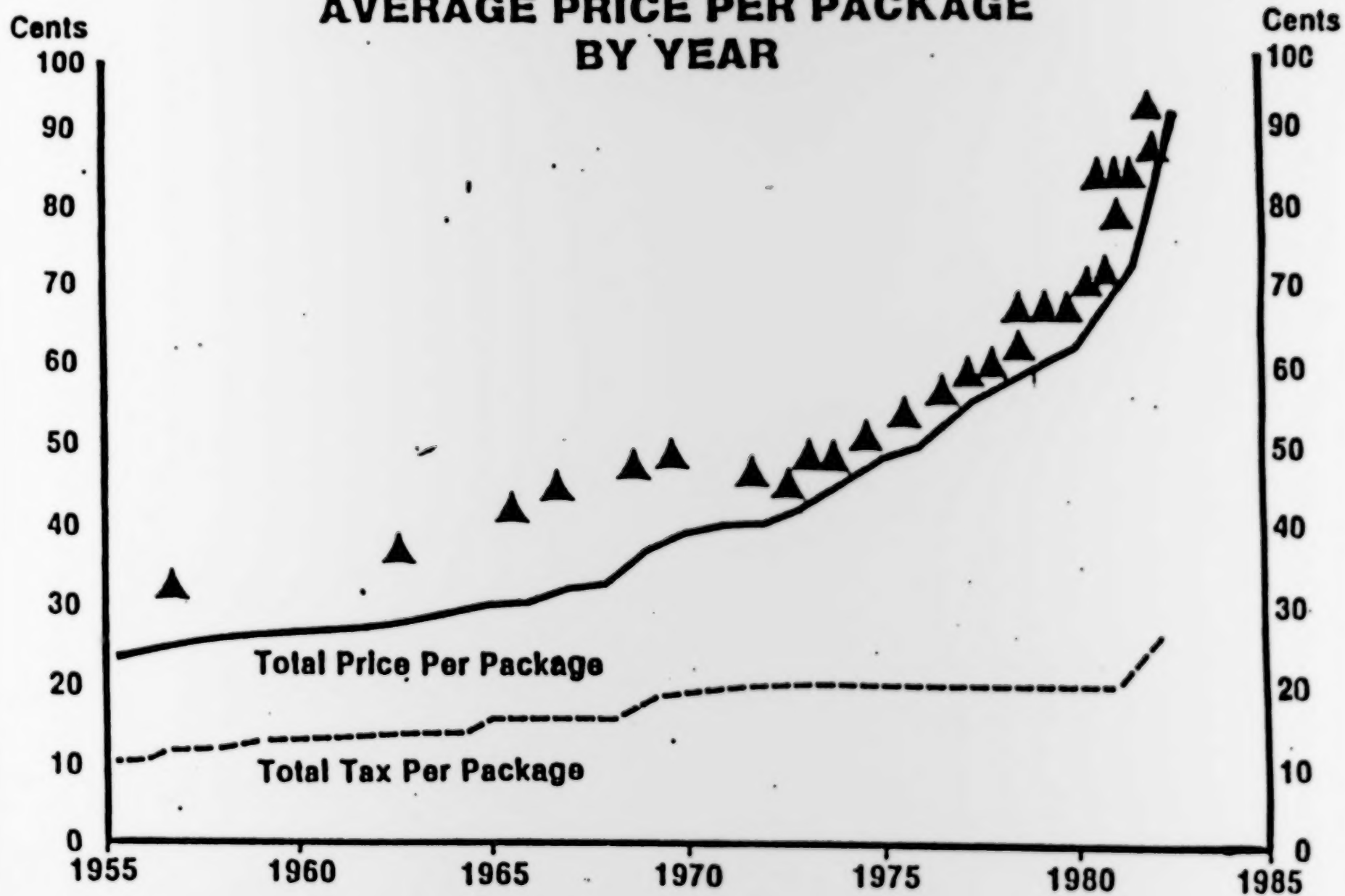
Liggett & Myers

1. *L&M will do whatever possible to increase generic distribution and sales.*
 - L&M is estimated to begin trying to contract for generic sales through increased types of retail outlets, seek longer-term generic sales contracts, if possible, develop private label long-term contracts, etc.
 - L&M has very little branded business to lose, so it will attempt to transfer new ideas to generics, as long as the business can be profitable for them.
-

[August 8, 1983]

CHART 11

CIGARETTES AVERAGE PRICE PER PACKAGE BY YEAR



▲ - Manufacturer's Price Increase

Source: Tobacco Tax Council

[August 8, 1983]

CHART 12
MANUFACTURER'S PRICING
 vs.
CPI
5/74 - 6/83

INDEX
 6/70 = 100

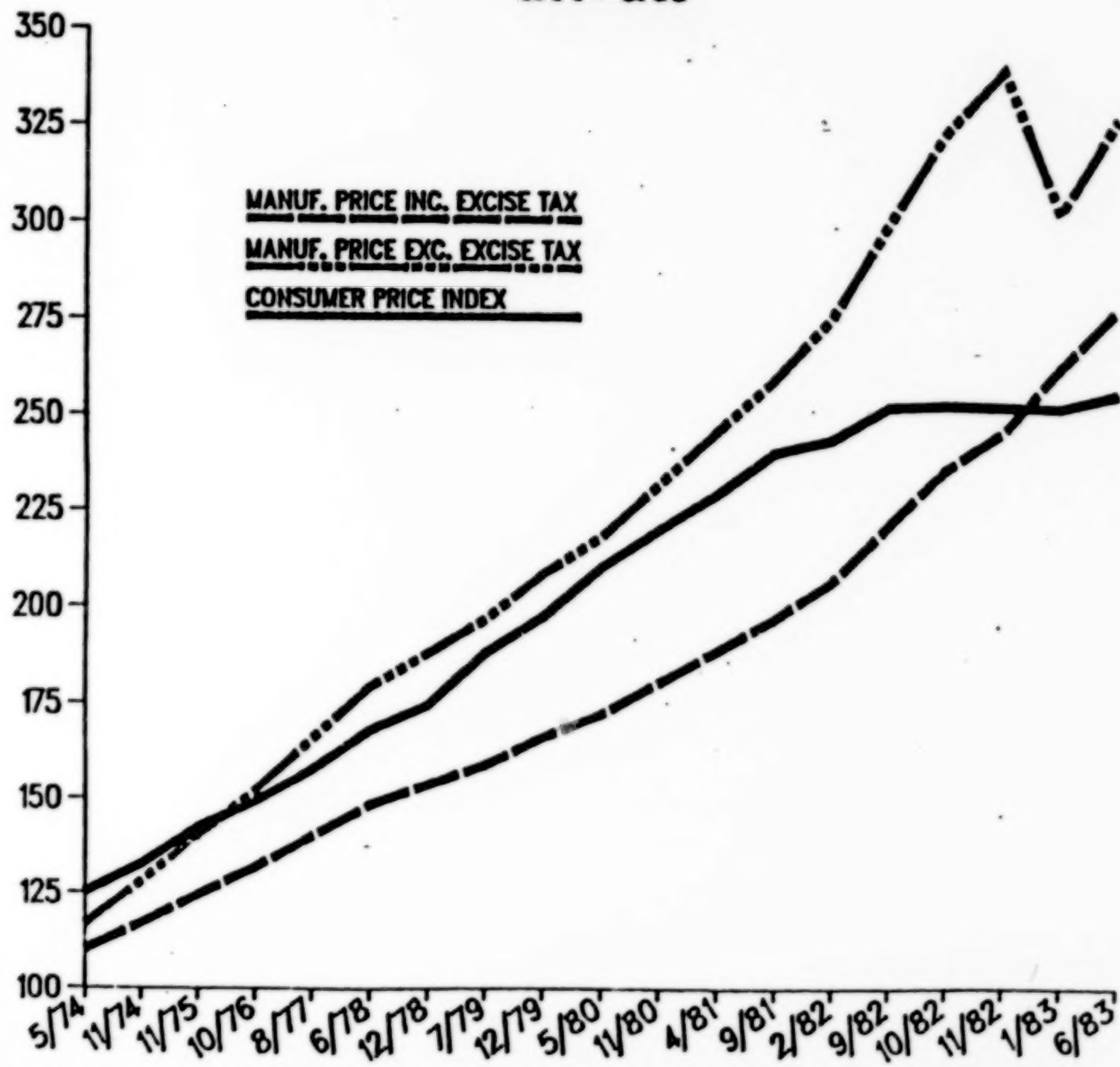
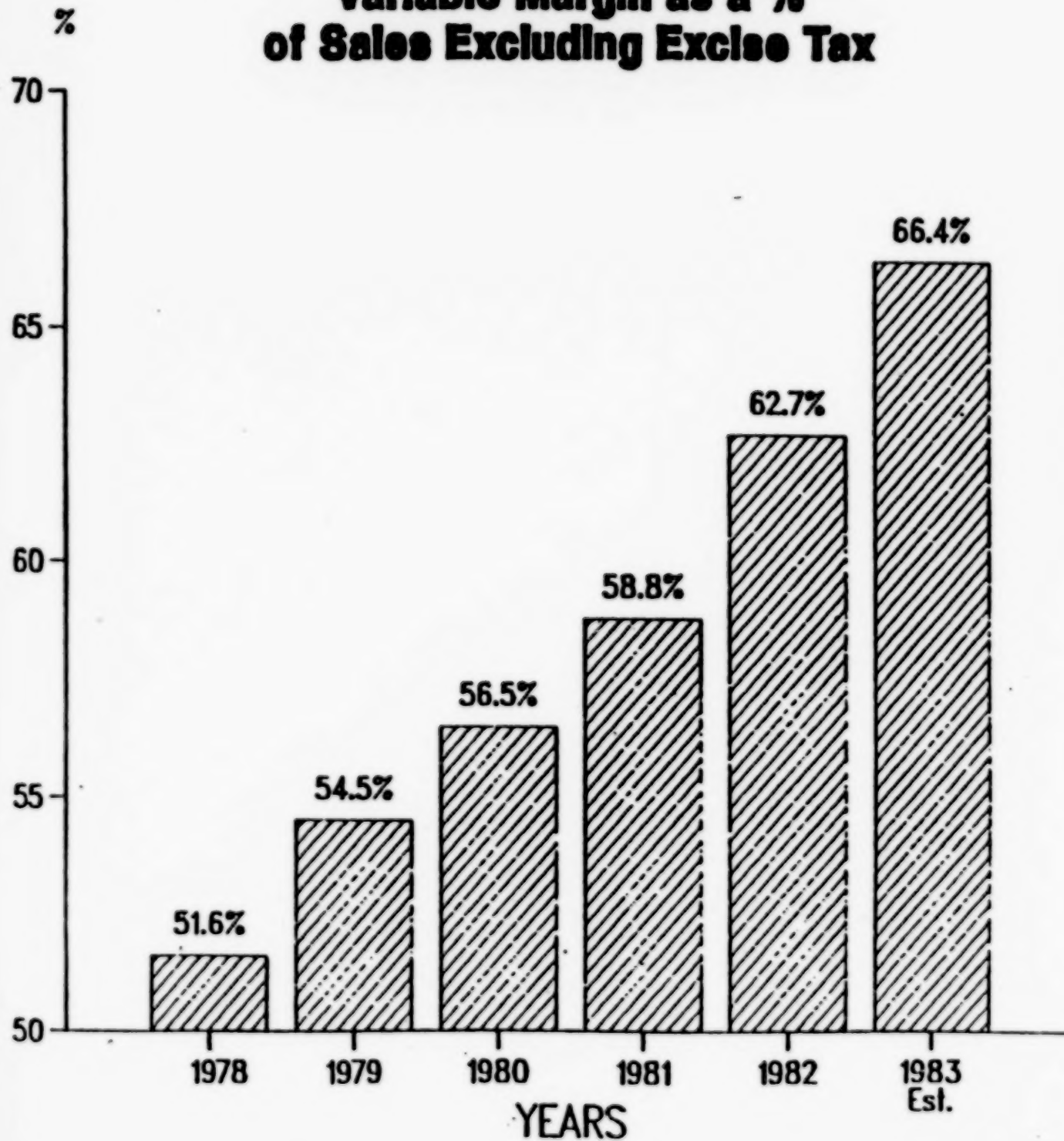


CHART 13 [August 8, 1983]

MARGIN TREND
Variable Margin as a %
of Sales Excluding Excise Tax



GARY TOBACCO COMPANY
STRATEGIC PLANNING

AUGUST 31, 1983

* * *

II. ENVIRONMENTAL ANALYSIS

A. COMPETITION

- CURRENT COMPETITION (U.S. TOBACCO) NOT TO BE CONSIDERED A FACTOR IN LONG-TERM PLANNING
- POTENTIAL MAJOR COMPETITION
 - COMPETITIVE TIMETABLE FOR ENTRY, ADVANCED (DUE TO EXCISE TAX SUCCESS)
 - ACCELERATED PLANNING ANTICIPATED
 - MID-PRICED ENTRY PROBABLY (REFERENCE MAXWELL REPORT, EUROPEAN SITUATION)
 - VALUE ADDED OR 25 PACKS

B. SITUATION

- GENERIC/PRIVATE LABEL CONSUMER GOODS CATEGORY FLAT TO DECLINING
- U.S. ECONOMY APPEARS TO BE STRENGTHENING, I.E., INFLATION RATE HAS SLOWED
- CONTINUED STATE TAX INCREASES AND POTENTIAL FEDERAL TAX INCREASES ANTICIPATED

- SHORT-TERM ENVIRONMENT CONTINUES TO BE FERTILE; LONG-TERM UNPREDICTABLE
 - INDUSTRY PRICE INCREASES EXPECTED TO BE LESS FREQUENT AND/OR NOT AT SAME LEVEL AS HISTORICAL INCREASES (% INCREASES WILL DECLINE)
- * * *
-

LIMITED

BROWN & WILLIAMSON TOBACCO CORPORATION
INTERNAL CORRESPONDENCE

E.E.K.

JAN 25 1984

TO	<u>D.S. Johnston</u>	<u>H.A. Roeder</u>	<u>E.E. Kohnhorst</u>
DEPT.	<u>C.J. Dunn</u>	<u>C.J. Heger</u>	<u>R.H. Sachs</u>
C.C.to	_____	_____	_____
"	_____	_____	_____
"	_____	_____	_____

FROM E. T. Parrack, Jr. DATE January 25, 1984
SUBJECT Generics Work In Progress

PURPOSE

1. To provide background information on our analysis of Generics and
2. To request your help in locking up a timetable for launch.

[ILLEGIBLE]

1. Background draft document attached. Many numbers are still rough, subject to validation. Overall thrust is reflective of our thinking to date. E.G.:
 - a. Generics are growing: +0.1 SOM/month
 - b. L&M represents 97% of segment
 - c. Business is mixed between (numerous) white and private label styles

- d. Volume can be gained by offering a superior net price (same basic list) as L&M and superior customer service. (Service to be tailored by customer needs/sensitivities.)

2. We need your help on various timetable issues:

R&D/Man/Finance

a. Blend specification and standard costs

- 1) R&M Lights Kings, 100's
- 2) R&M Ultra Kings
- 3) R&M full taste
- 4) R 70mm plains

* * *

CURRENT

PRODUCT CAN BE SHIPPED WITH
OTHER L&M BRANDS TO MEET
MINIMUM SHIPPING REQUIREMENTS
TO ACCOUNTS

B. PRICE

17.25 PER M

2% DISCOUNT 10 DAYS NET

VOLUME DISCOUNT

FROM 0-5¢ (1983)

8,000 CASES/YR. = 5¢/CTN.

4,000 CASES/YR. = 1¢/CTN.

GROWTH DISCOUNT

UP TO 20¢/CTN. REBATE ON VOLUME
OVER AND ABOVE LAST YEAR'S
SALES

ADVERTISING DISCOUNT

UP TO 12¢/CTN. FOR 60-90 DAYS
(OCT.-DEC. 1983)

DISPLAY FIXTURE ALLOWANCE

VARIES FROM CHAIN PURCHASE
AND OWNERSHIP TO FREE FIXTURES

NO RETURNED GOODS - ALL SALES
FINAL

BACKGROUND

- HELPS L&M
MAINTAIN
DISTRIBUTION ON
MARGINAL BRANDS

TARGET
PER QTR.

2,000 CS.

1,000 CS.

250-

1,000 CS.

VOLUME
DISC.

5¢/CTN.

3¢/CTN.

1¢/CTN.

"GROWTH"
DISC.

15¢/CTN.

13¢/CTN.

11\$/CTN.

VOLUME OR
PROMOTION
DISCOUNTS OFF
INVOICE AND
THROUGH REBATES

ALL CONTRACTS
DRAWN BY GARY
TOBACCO

RETAIL CHAIN/
WHOLESALE PAYS
GARY TOBACCO FOR
AD AND RECEIVES
BETTER RATES

NO AUTHORIZED
PAYMENTS BY GARY
TOBACCO FOR
DISPLAYS

THE REAL PRICE OF GENERICS TO MAJOR ACCOUNTS IS DISGUISED BY THE VARIOUS DISCOUNT SCHEMES AND ALLOWANCES. THEY HAVE USED PRICE AS THEIR KEY STRATEGY FOR GROWTH. NO PRICE INCREASES PLUS INCREMENTAL VOLUME DISCOUNTS.

PRICING*MANUFACTURER'S PRICE (PER THOUSAND)

(LIST - DISCOUNT)

B&W : 28.20

\$11.51 SPREAD

GENERIC: 16.69

↓

DIRECT ACCOUNT PRICE

(INCLUDES STATE TAX)

B&W : 38.58

\$10.33 SPREAD

GENERIC: 28.25

↓

RETAIL ACCOUNT
PRICE →TO CONSUMER:
(PER CARTON)

B&W : 42.25

8.45

\$9.35 SPREAD

1.87/CTN. SPREAD

GENERIC: 32.90

6.58

*MAJOR VARIANCES OCCUR AT EACH POINT BELOW
MFG LIST DUE TO:

- STATE/CITY TAXES
- DIRECT ACCOUNT VOLUME DISCOUNTS TO CHAINS
- CHAIN PRICING STRATEGY

* * *

/LR/522T

OBJECTIVE
A. VOLUME
6 BILLION UNITS DURING
FIRST YEAR

- STRATEGY
1. DEFINE TARGET CUSTOMERS. IDENTIFY THE MAJOR ACCOUNTS WHICH B&W MUST ACQUIRE IN ORDER TO ACHIEVE VOLUME
 2. ACHIEVE MAXIMUM DESIRED VOLUME THROUGH A MINIMUM NUMBER OF CUSTOMERS. THIS ALLOWS FOR COST EFFICIENCIES AND TAILORING OF THE OFFER TO MAKE IT UNIQUE, SUPERIOR (TO COMPETITION) AND MORE DIFFICULT TO MATCH. CREATE A PROGRAM MIX FLEXIBLE ENOUGH TO PROVIDE CUSTOMERS SATISFACTION AT MINIMUM COST.
 3. DEFINE THE KEY SELLING - LEVERAGE POINTS OF EACH ONE OF OUR LARGEST VOLUME ACCOUNTS.
 - DETERMINE TOTAL COSTS B&W IS WILLING TO INCUR BASED ON VOLUME FOR EACH CUSTOMER
 - MATCH CUSTOMER NEEDS TO PROGRAM OFFER

THE EFFECT OF SUCCESSFULLY PURSUING THIS STRATEGY IS TO DEVELOP AND MAINTAIN

FOCUS
- MARKET SEGMENTS BY VOLUME

- I. MILITARY
A. OVER 2 BILLION UNITS
B. SEGMENTS
- COMMISSARIES
- EXCHANGES

<u>TYPE</u>	<u># BUYING OFFICES</u>	<u>% VOLUME (B&W) (OF MILITARY & INST.)</u>
AIR FORCE COMM.	172	47.36
ARMY COMM. ARMY & AIR FORCE EXC.	6	14.24
NAVY EXC.	68	10.95
MARINE EXC.	30	2.42
COAST GUARD EXC.	18	2.33

C. GENERIC SHARE GROWTH (EST.) 10-12% OF MILITARY CIGARETTE BUSINESS AND GROWING

<u>MILITARY - 1982-1983</u>					
1ST QTR '82	2ND QTR '82	3RD QTR '82	4TH QTR '82	1ST QTR '83	3RD QTR '83
2.6	3.09	3.76	4.59	6.16	7.84

Lehman Brothers Research

Industry Comment**The Maxwell Report
Revised 1983 Year-end
Sales Estimates for the
Cigarette Industry**

John C. Maxwell, Jr.
(202)558-2287

February 2, 1984

LEHMAN BROTHERS KUHN LOEB INCORPORATED
55 WATER STREET, NEW YORK, NEW YORK 10041
(212) 558-1500

THE MAXWELL REPORT**It Was A Difficult Year**

The cigarette industry's 1983 volume was on target with our preliminary figures. In October we estimated total consumption at 596.59 billion units; the actual number was 596.19 billion, down 4.5% from 1982.

We believe that 1984 will be another difficult year, and we are not sanguine about much of an uptick. Taxes were increased by 14 states in 1983, preponderantly in the latter part of the year, with boosts averaging \$0.06. This year at least 10 more states are expected to increase taxes. On average, taxes now account for 37% of retail cigarette prices. An average pack on November 1, 1983 (before the latest price hike) cost \$0.95. Thus, there is the possibility that industry numbers could be flat or down in 1984 and beyond.

Generics are now running at an annual rate of 3.5% of the market against 2.9% for 1983, and we suspect that generics' 1984 share will be in the 3.5%-4% area. The industry can no longer neglect this growing sector, and there could be two attacks in this area. The first is obvious - other companies could introduce generics. The second would be for some smaller companies to reintroduce a few of their tired brands as discount products. We suggest that products that have used coupons in the past might be among the first out. If this were to take place, we would expect responses from larger companies, which could introduce new brands to compete in the discount sector. We would not be surprised to see this type of situation transpire in the next six months.

At press time, R.J. Reynolds had just announced plans to run a series of ads to put the health issue into better perspective. This is the first time the industry has publicly defended itself against the health activists, and we think it is a constructive move.

Our other comments in the October 25, 1983 Maxwell Report remain intact.

MEMORANDUMLIMITED

TO: MR. C. J. HEGER
[Crossed out]

FROM: MR. A. C. DIEBOLD

DATE: FEBRUARY 7, 1984

SUBJECT: GENERIC BUSINESS

At your request, I have roughed out the potential loss which would accrue to B&W assuming we would manufacture and sell 18 billion units of Generics at a breakeven point at the variable margin level. The results of my calculations are given below.

	<u>Annual Loss</u> <u>\$000</u>
A. Loss in interest income of funds tied up in working capital related to Generics (calculated at 12% of roughly \$120 million).	\$ 14,400
B. Approximate cost (loss) of incremental overheads (Macon Branch at 40¢ per M)	7,200
C. Estimated cost (loss) of marketing and selling field and/or broker's fees at 60¢ per M	10,800
Total in terms of current dollars	<u>\$ 32,400</u>

Sensitivities regarding "Target" value will be developed shortly.

/s/ A. C. Diebold
A. C. D.

/sr

GENERIC PRESENTATION

FEBRUARY 9, 1984

* * *

SITUATION ANALYSIS

1. L&M IS THE GENERIC SEGMENT AND B&W IS A MAJOR CONTRIBUTOR TO ITS GROWTH.

L&M ENTRY:

- 1983 • 97% OF TOTAL GENERIC SEGMENT
- 1983 • 3.77% OF INDUSTRY VOLUME (NOVEMBER 1983)
- 1983 • +16 BILLION UNITS ANNUALLY
- 1984 • .083 SHARE POINTS PER MONTH (PROJECTED) GROWTH RATE
- 1984 • 24 BILLION UNITS (PROJECTED)

B&W CONTRIBUTION:

- 1982 • 4.9% OF B&W'S LOSSES WERE ATTRIBUTED TO GENERICS (MAY 1982 SWITCHING STUDY)
- 1983 • 14.2% OF B&W'S LOSSES WERE ATTRIBUTED TO GENERICS (MAY 1983 SWITCHING STUDY)
- 1983 • 23% OF GENERIC GAINS WERE (FORMER) B&W SMOKERS (MAY 1983 SWITCHING STUDY)

* * *

GENERIC

OBJECTIVE:

TO DEVELOP AND EXECUTE A PROGRAM WHICH WILL DELIVER VOLUME YEAR ONE OF SIX BILLION CIGARETTES

CONSTRAINTS:

1. DO NOT ACCELERATE SEGMENT GROWTH
2. DO NOT ACCELERATE GENERIC EROSION OF B&W EXISTING BUSINESS
3. AVOID/MINIMIZE DIVERSION OF B&W RESOURCES
 - HUMAN
 - FINANCIAL
 - MANUFACTURING

GENERAL PRODUCTS STRATEGY

ACQUIRE 6 BILLION STICKS IN 1984 BY:

1. OFFERING WHITE LABEL
PRIVATE LABEL
PRODUCTS COMPARABLE TO L&M's
TO ALL TRADE CUSTOMERS
2. OFFER SUPERIOR NET COSTS TO L&M
 - A. SAME LIST PRICE
 - B. SUPERIOR
 - 1) VOLUME DISCOUNT (FRONT LOADED CREDIT FOR STOCK)
 - 2) GROWTH DISCOUNT
 - 3) MERCHANDISING ALLOWANCES
 - 4) FIXTURE ALLOWANCE

- STRATIFIED BY CUSTOMER VOLUME

3. FOR MILITARY:

OFFER SUPERIOR PRICE FOR A BRANDED GENERIC

* * *

- . . . WHY NOT STRAIGHT PRICE COMPETITION?
- REDUCING THE LIST PRICE TO DIRECT ACCOUNTS WOULD:
 - ↓
 - ENCOURAGE SUPPLIERS TO REDUCE THEIR SELLING PRICE TO RETAILERS.
 - ↓
 - ENCOURAGE RETAILERS TO PASS ALONG THESES SAVINGS TO CONSUMERS AND STIMULATE USE OF GENERIC CIGARETTES AS A LOSS "LEADER."
 - ↓
 - WIDEN THE PRICE DIFFERENCE BETWEEN GENERICS AND BRANDED CIGARETTES
 - ↓
 - MAKE MORE SMOKERS RECEPTIVE TO "PRICE VS. IMAGE" TRADE OFF.
 - ↓
 - ACCELERATE SEGMENT GROWTH.
 - ↓
 - CONTINUE AND INCREASE RATE OF EROSION ON B&W BRANDS TO GENERICS.
 - ↓
 - FORCE ACTION BY L&M AND OTHER MANUFACTURERS.

- ↓
- FURTHER EXPLODE CATEGORY.
- ↓
- FURTHER REDUCE PROFITABILITY.

* * *

HOW DO WE GET THE BUSINESS

1. Equal or better L&M's offer by customer.
2. Generate target volume from minimum number of customers.

PROGRAM

1. Match L&M list price.
2. Offer discounts (per carton) to:
 - 5 levels - Domestic
 - (Military Separate)
3. Structure terms and discounts based on volume and exclusivity.

DOMESTIC VOLUME LEVELS

<u>LEVEL</u>	<u>VOLUME (CASES PER YEAR)</u>
1	OVER 25,000
2	12,000 - 24,999
3	6,000 - 11,999
4	3,000 - 5,999
5	1,000 - 2,999

[Approximate Date:
1st quarter 1984.
See Tr. 23:106,112]

[Handwritten Notes]

Short Term -

Long Term - a) maint. Seg. [Illegible]
b) [Illegible] Segment [Illegible]
c) limit potential for competitive [Illegible] & response

Sub Head (Implications)

Assume --- (from prev. page)
of monthly volume flow chart

strategy -

Investment strategy

two tiered

[utilize full net VM to obtain business 1984

Volume generation strategy, obtain vol from top cust.
Implication - show deal to customers.

Match L&M List under L&M in Military use discounts

↓

Superior offer in simplified form.

Distribution

Volume Levels

Military

Product

Start by Matching styles - not specs - closer in net delivery to L&M's product -

Packaging -

break out white label vs. private label

"Make it look like theirs" - for all customers - minimize visible difference in product offerings

- do we go directly after GPC contract

- Primary call
- Leveraged call

RJR intensify coupons:

PM - Continue/intensify sampling
- enter coupon
- tape on

When loss rate to generics exceeds RJR SOM drops below #1

If B&W not in

Someone else will PM/RJR sooner if we don't go in.

Someone must put a lid on L&M - if we do - does someone else need to??

No reason to increase spread - no proof that it will increase volume financial impact of growth of generics on VM - what is it worth to defend volume

RJR/PM "branded generic" side

Signal intent to competition - not expand segment protecting ourselves - get back what we lost.

Profile of LOK ACC cost of goods.

[Illegible] incremental bus. if can get in efficiently

- reducing dependence on cigarettes

RJR PM - tobacco philosophy & orientation

[Approximate Date:
1st Quarter 1984.
See Tr. 47: 196]

GENERIC
CIGARETTE
CATEGORY

* * *

To compete head to head with Liggett on the price frontier would be a very risky business. They have already demonstrated restraint in raising generic prices, moreover, faced with competition it is believed they would not hesitate to lower prices. The generic category is L&M. Any threat to generics is a threat to their existence. If the wholesalers and chains believe that a new entry at a reduced price will merely serve to drive down the price of their current generics, they will not replace the system they already have in place. Moreover, there is little reason to believe that they will carry similar discounted brands manufactured by two companies. Product differentiation must be apparent.

PLACE

We learned from Liggett's history that:

1. Generic strength is regional in nature (as is generic weakness).
2. Distribution is essential in chains, supermarkets and distributors.

The cause of the regional variability in share development is not singular and needs further study from two perspectives:

1. Why do generics sell (in some areas)?
2. Why *don't* generics sell (in other areas)?

For B&W, these answers are prerequisites of plans for any roll out, creation of an image, and an overall better understanding of what is driving the category.

If a B&W entry into the category could replace the Liggett brands in distribution (versus competing side by side), then the category would be ours. The key then is to offer a better overall program to wholesalers than Liggett currently offers and superior to *whatever* Liggett is capable of producing. Matching their program and touting a superior product and/or sales effort may not be enough to dislodge their monopoly of the distribution channels.

PROMOTION

Promotion pays out when:

1. It leads to heightened positive awareness which leads to trial and repeat purchases (to date, it is difficult to say that many smokers have really *converted* to generics).
2. It causes better in-store visibility and availability to the same end (i.e., repeat purchases).

Liggett's promotion through co-op advertising and fixtures does this better than most promotion efforts because they have been able to emphasize the price spread between generics and 20's, demand quantity purchases (which reduces out-of-stocks) and have attained prime display space to insure visibility. Furthermore, the chains and distributors have a "vested interest" in the

product due to stock investments, no returns and higher margins.

Successful competition in the category almost requires displacing Liggett's position at retail and with wholesalers and chains to obtain the necessary support. Liggett's message is clearly quality and value. While their quality has not been perceived as commensurate with branded products, its value due to price has. Another entry singing the same song may need more apparent evidence of superior quality and value to distinguish itself from generics.

SUMMARY

A product designated to successfully compete in Liggett's generic category must be able to:

1. Dislodge a large portion of the current and future L&M generic and private label smokers.
2. Develop a permanent, loyal franchise that does not whither [sic] with an improved economy.
3. Satisfy the chain and distributor needs so as to create the same kind of "vested interest" that Liggett has achieved which will insure acceptance, participation, and product availability.

In essence, *beat their deal*. But it must be done in a way that cannot easily be duplicated.

[February 1984.
See Tr. 9:103, 106]

SITUATION ANALYSIS

I. *Background*

Generic cigarettes currently have over 3.5% of the total U.S. cigarette business. No one in the industry – including Liggett and Myers – anticipated this rapid growth and widespread acceptance.

To position B&W's generic program, the following subjects have been analyzed:

- The market for generic products in general.
- The market for generic cigarettes
 - generic cigarettes versus generic products
 - generic cigarettes versus branded
- L&M: A historical review of their success.
- Additional "Value for Money" options to explore.

A. *Generic Product Development*

Generic products have developed over the past five years driven by changing social trends, lifestyles and values.

The 1983 Yankelovich Monitor of social trends reports that consumers are shifting at an increasing rate away from the following attitudes, values and lifestyles:

1. Immediate gratification (Hedonism)
2. Belief that "qualify life" will always improve in the U.S.

3. Dependence on physical attributes and brand name possessions to portray self worth

These changes create potential for generics: some consumers are willing to sacrifice brand names for a lower price. They realize that a certain portion of a product's selling price results from the advertising and promotion costs of image presentation (versus real product difference). From these realizations, new values are forming: some consumers believe they can distinguish quality without depending on reassurance of brand name (self reliance).

* * *

B. L&M Generic Strategies

L&M's rapid development in the generic segment has resulted from a number of key strategic decisions. These include:

1. *Taking advantage of marketplace dynamics by widening the price differential between branded cigarettes and generics.*

When L&M chose not to raise prices during the general price increase in December, 1982, July, 1983, and again in December, 1983, at which time the federal excise tax was doubled, share gains were immediate and dramatic.

		<u>Manufacturing Net Selling Price</u>		
		<u>Jan.</u> <u>1983</u>	<u>July</u> <u>1983</u>	<u>Jan.</u> <u>1984</u>
<u>Branded</u>				
	Kings	\$ 26.03	\$ 27.48	\$ 28.20
	100's	\$ 26.99	\$ 28.44	\$ 29.17

<u>Generics</u>			
Kings	\$ 16.90	\$ 16.90	\$ 16.90
100's	\$ 17.89	\$ 17.89	\$ 17.89

Margin Spread - Branded vs. Generic

	<u>Jan.</u> <u>1983</u>	<u>July</u> <u>1983</u>	<u>Jan.</u> <u>1984</u>
<u>Dollars</u>			
Kings	\$ 9.13	\$ 10.58	\$ 11.30
100's	\$ 9.10	\$ 10.55	\$ 11.28
<u>Percent</u>			
Kings	35.0%	38.5%	40.0%
100's	33.7%	38.4%	38.7%

The result of this strategy was that more consumers were willing to make the tradeoff as branded cigarettes shifted to a more price elastic position on the demand curve.

* * *

Brown & Williamson Generic Objectives

Year 1 *Became a dominant factor in the generic market, targeting for at least a 60% share of the generic market at end of Year 1.*

Given that the Company cannot be certain how quickly volume will be established, we project that volume falling into 1984 will be between 3.7 and 6.0 billion sticks (detailed in the financial section).

Outyears *Maintain dominance of the generic market (at least a 60% share of the generic market).*

Other key long-term objectives are to:

- Manage segment growth
- Limit potential for competitive entries by minimizing profit capability

- Minimize generic erosion of B&W existing business
- Minimize diversion of B&W resources
 - Human
 - Financial
 - Manufacturing

These objectives will be achieved while other full major margin brands are being developed for marketplace implementation.

Brown & Williamson Generic Strategies and Tactics

I. *Investment Strategy*

B&W's generic investment strategy is to spend up to net variable margin in order to achieve share objectives (\$2.67/M).

This spending strategy will provide customer support advantages versus L&M. In the event that L&M decreases their price, B&W's contingency plans are to have a "cushion" in cost per thousand which will allow B&W to match L&M's offer down to full variable margin (\$3.17/M if necessary); however, we would not go below full variable margin to a point where we would be losing money.

In addition, B&W plans to customize support so it is most responsive to customer needs (in essence, not vary total support on a carton basis among similar volume accounts, but possibly vary how the money is spent).

II. *Volume Generation Strategy*

Required volume will be achieved by going to the minimum number of major customers necessary.

This is the most cost efficient and effective means of gaining generic dominance in the shortest period of time.

Further, the Company will work to obtain a share of key account generic volume still under contract with L&M targeting to become the sole supplier when contracts come up for renewal.

III. *Product Strategy and Tactics*

B&W's overall product strategy for generics is to offer high quality cigarette products which are similar in product acceptance to current generics.

In addition, we plan to offer a by-style line-up similar to current generics.

The basis for this product strategy is that comparability will limit consumer acceptance issues. Comparable products will also ease trade sell-in.

Our product line-up is recommended as follows:

* * *

IV. *Pricing and Bonus Payments Strategy and Tactics*

B&W's generic pricing strategy is to match the L&M list price but make the B&W total offer more attractive by offering greater bonus payments.

The rationale for this strategy is that it will place B&W in an advantageous position to sell-in our offerings, but will not tend to make the segment more attractive to other cigarette companies. For perspective, if B&W reduced the list price to accounts, it might lead to the following unacceptable scenario:

- Reducing the list price to direct accounts would:
- Encourage suppliers to reduce their selling price to retailers.

- Encourage retailers to pass along these savings to consumers and stimulate use of generic cigarettes as a loss "leader."
- Widen the price difference between generics and branded cigarettes.
- Make more smokers receptive to "price vs. image" trade off.
- Accelerate segment growth.
- Continue and increase rate of erosion on B&W brands to generics.
- Force action by L&M and other manufacturers.
- Further explode category.
- Further reduce profitability.

In the B&W program, discounts per carton will be offered at five different volume levels. Terms and discounts will be structured to be based on volume and exclusivity.

B&W's bonus program will consist of the following major elements:

* * *

FINANCIAL

GENERIC LONG TERM PRICING STRATEGY

B&W's long term pricing strategy is as follows:

- Manage the category growth by preventing an increase in the *percent* pricing spread between generics and branded cigarettes. This will be accomplished via one of the following tactics, depending upon the environment at the time of price increases:

- Maintain a constant percent margin difference (at 40%) between the prices (Schedule I)
- Allow the percent difference to decrease by maintaining a constant dollar spread (Schedule III)
- Maintain a fixed dollar amount of *contractual* trade allowances for direct buying customers and non-direct chain accounts.
- Build in "contingency reserve" of dollars which can be used to maintain dominance of the segment and combat competitive entry.

The strategies for pricing were developed based upon the need to determine a list price which will be consistent [sic] with B&W's major objectives of:

- Generating volume
- Dominating the category
- Managing the category growth
- Minimizing opportunities for competitive response

This requires consideration of both list price and trade allowances over the next five years according to the estimated price increases on B&W's branded product lines.

Three schedules are attached which show how various changes in list price and/or trade allowances would affect B&W trading profit. Schedule IV is provided as an indication of how a mid-point price would compare to branded product and generic product pricing over time.

Further explanation is as follows:

1. Schedule I maintains a generic price increase which is 60% of the expected increase on B&W branded cigarettes.

Although this will increase the *dollar* spread between generics and branded, the *percent* difference remains constant. Consumers will not have increased motivation to trade-off image for price as *has been* the case with L&M not increasing their prices on generics when branded product prices increased.

Schedule I also maintains trade allowances over time at an average of \$1.65 per thousand. This serves to discourage passing along incremental allowances to the retailers and consumers, which would further expand the category.

Schedule II, which is not recommended, shows the bottom line results under a similar pricing scenario, but where B&W retains only a portion of each price increase to cover incremental costs and passes along the balance to the trade in the form of increased allowances.

2. Schedule III presents another viable tactical approach to our pricing strategy. Instead of maintaining a *constant* percent margin difference between generics and branded, this strategy maintains a constant dollar spread which *decreases* the *percent* difference. This allows us the flexibility needed to respond [sic] quickly to the competition by using short term trade allowances which are not bound by contracts or extended time frames. For example, B&W could offer an extension of (up to) three months at the old price when prices increase on generics.

* * *

GENERIC COMPETITIVE RESPONSE

This section discusses possible competitive responses to the generic segment.

Liggett & Myers

In the absence of any direct competition, L&M will continue to build the generic category. It is almost certain that if Brown & Williamson entered the generic segment, Liggett & Meyers [sic] will react vigorously:

- Generics represent about 60% of L&M's volume. Without generics, L&M's tobacco business would be irreparably damaged.
- Liggett can react. While Liggett may have more short term capacity problems than any other company in the industry if they continue to increase market share, we know that they have ordered seventeen high speed cigarette makers and that would provide them with more than four incremental market share capability. The delivery schedule for this equipment is not known.

We believe the following competitive scenario may be the most likely:

1. L&M first meets Brown & Williamson's offer in the military and categories I and II. In addition, L&M may add full taste, Kings and 100's to their product line and expand sales support. Expansion into full taste could pose a particular threat to KOOL.

If this happens, we believe Brown & Williamson still has a good chance of securing generic volume due to our ability to

provide better service and the belief that distributors and chains would prefer doing business with us because of our size and perceived stability.

Brown & Williamson would match L&M's move to a full product line. If L&M goes to full sales support, Brown & Williamson would match customer service through one or more of the following: temporarily "borrowing" the B&W sales force and possibly blitzing at wholesale/retail; increasing permanent part-time help; and seeking additional broker resources.

2. If after matching B&W's offer, Liggett begins losing generic volume, or Brown & Williamson is not able to secure new volume, then one of the competitors will spend down to spend full variable margin (i.e. zero profit at \$14.08/M for B&W). Assuming that the points are basically similar for both companies (there are insufficient data to conclude otherwise), we would expect the other competitor to match this offer.
3. If L&M goes below our full variable margin, Brown & Williamson would not plan to match their offer.

As such, under all likely scenarios B&W stands to capture a major part of the segment. We would not expect L&M to be able maintain any loss position long term.

It is possible that L&M may choose to retain only the profitable, smaller

accounts, leaving B&W to have the larger, less profitable generic business [sic] (the opposite scenario is also a possibility).

R.J. Reynolds

We consider Reynolds a likely candidate for entry into generics or a third price point. Further, it is possible that their entry may be accelerated if Brown & Williamson does *not* enter the segment, in order to control it. The reasoning is as follows:

1. If the continued growth of generics is not contained by another company and Reynolds concludes that not only are profits but generics are affecting the company's ability to regain its number one position in the cigarette category, it may be forced to react.
2. Reynolds currently loses more volume to generics than any other company.

R. J. Reynolds Contribution to Generics

<u>Current Smokers</u>	<u>Contribution to Generic Gains</u>	<u>Index</u>
32.6	38.5	(118)

Source: Switching Study, Wave 35

In addition, Winston is currently the largest contributor to generics, providing close to 20% of generic gains (the next highest is Marlboro at about 11%).

Note that from a capacity standpoint, Reynolds sold about 20 billion fewer cigarettes in 1983

than in 1982. It can therefore be assumed that the company has excess capacity at least to this point on a five day work week, and this could increase significantly if a six or seven day work week is considered (as a non-union manufacturer, Reynolds should not have a problem moving to a longer work week).

Reynolds' initial reaction to continued generic growth might be to heavily coupon/discount its branded lines to try and neutralize the generics' advantage. If this tactic is unsuccessful, RJR may launch/reposition a brand at a third price point. A third price point may offer Reynolds more leverage and control than just going to generics, since it can establish its own pricing/margin structure and leverage RJR's sales force strength. In addition, it may be a sounder course of action from a legal standpoint to avoid any possible anti-trust action, which could result from taking on head-to-head a small manufacturer and possibly putting them out of business.

One likely scenario for this price point is that Reynolds would reduce the price on one of its existing marginal brands, such as Doral, which currently has a share of .19 (off 0.05 share points in 1983).

If Reynolds or another competitor entered generics or a third price point prior to B&W, we would of course assess how that scenario affected our proposed program and react accordingly. One likely tactic would be for B&W to move as soon as possible to test a mid-priced brand.

Philip Morris

Similar to R. J. Reynolds, we believe the possibility of Philip Morris' entry is reasonably high, particularly if the segment is not managed by one of the smaller companies. In addition, if Philip Morris' number one position begins to erode, Philip Morris may react regardless if Brown & Williamson enters or not.

1. Philip Morris has a strong rationale for immediate entry. Their brands are image-driven; by entering the generic segment, they put all competitors in a vice between full price/high image offers and generics thereby gaining the potential to dominate both the top and bottom of the category, leaving competition to fight over the shrinking middle.
2. However, there have been rumors of late that Philip Morris may be getting ready to move into the "Value for Money" segment. These unsubstantiated rumors but have come from both the Midwest and New England [sic]. One of these rumors said that Philip Morris or Reynolds would enter the segment if Liggett gets one more share point.

Similar to Reynolds, we deem the possibility of Philip Morris reducing the price on one of its marginal brands as not unlikely. In Philip Morris' case, a possibility might be Saratoga or Philip Morris brand. Saratoga had a .33 share in 1983, -0.01 versus 1982; Philip Morris brand had a .14 share in 1983, also off -0.01 versus year ago [sic].

From a capacity standpoint, Philip Morris sold about the same number of sticks in 1983 than it did in 1982 (204.7 billion sticks versus 204.4 billion sticks). However, Philip Morris has recently modernized their plant in Louisville and is in the process of starting a new factory in North Carolina. It can be assumed that Philip Morris has, or can obtain, the necessary production capacity to react to any demands in the marketplace. Engineering estimates Philip Morris has machines which would provide packing capacity in a three shift, five day work week in excess of 250 billion cigarettes per year, almost 50 billion cigarettes more than they sold in 1983.

American & Lorillard

- In the foreseeable future, we believe that the possibility of American or Lorillard entering the Generic segment is relatively unlikely, whether Brown & Williamson competes in this category [sic] or not:

1. Neither company has an aggressive tobacco philosophy. In this regard, a statement made about a year ago by an American top executive said that the company's non-tobacco strategy "is aimed at rejuvenating the company, expanding its earning space, reducing its dependence on tobacco and pulling American out of its nostalgia for days when it was the only tobacco company in America". American is estimated to fund the domestic tobacco business only to the extent necessary to provide cost effective manufacturing, advertising

and sales promotion and to maintain relatively stable income.

Similarly, a major objective of Loew's is to maintain a relatively stable cash flow from its tobacco business to fund other businesses.

2. Both companies have been hurt less than fair share by the introduction of generics.

Contribution to Generics by Manufacturer

	Contribution to Current Smokers	Generic Gains	Index
American	7.8	7.5	96
Lorillard	9.6	8.0	83

Source: Switching Study, Wave 35

3. It is unlikely that either American or Lorillard would commit the funds/use of variable margin necessary to compete effectively in the generic category.

From a capacity standpoint, American probably still has significant capacity, based on recent volume/share declines. Lorillard's capacity is not clear. Their volume has held relatively steady since 1979 but Engineering reports they may be operating only on two shifts. In any event, we do not believe Lorillard would commit to large incremental capital expenditures.

LIGGETT & MYERS TOBACCO COMPANY

FEBRUARY 14, 1984

***** AGENDA *****

OPENING REMARKS AND MANAGEMENT PHILOSOPHY	K. V. DEY
MARKETING & SALES STRATEGY	HAL GRANT
OPERATIONS & PRODUCT ASSUR- ANCE	JIM TURNER
FINANCIAL REVIEW	DAVE WELSH
L&M DO BRASIL	DAVE WELSH
ADMINISTRATIVE & LEGAL SUM- MARY	K. V. DEY

* * *

GENERIC/PRIVATE LABEL
COMPETITION

- DOMESTIC COMPETITION - GET 4 NEW SMOKERS FOR EACH ONE THEY LOSE
 - \$3.00 PER M VS. \$13.00 PER M MARGIN
 - U.S. DISTRIBUTORS EXTREMELY HAPPY WITH GARY'S STRATEGIC SELLING SYSTEM. "THEIRS NOT OURS".
 - COMPETITION WOULD NOT GAIN INROADS BY MEETING OUR PRICE - WOULD HAVE TO BE SIGNIFICANTLY LOWER.
 - MANUFACTURING WOULD BE LOGISTICAL NIGHTMARE. CURRENTLY NOT SET UP FOR LOW VOLUME PRODUCTION RUNS.
-

[Handwritten Note]

Final FC 3/9

[March 9, 1984.

See Tr. 30:106]

BROWN & WILLIAMSON GENERIC PROPOSALI. *Current Situation*

An economy and value for Money segment are emerging in the U.S. cigarette market. These segments include generic, 25's and mid-priced brands.

Generics have enjoyed phenomenal volume growth since introduction in 1980, growing to over 17.5 billion units in 1983 and achieving virtually full national distribution in all classes of trade lead by supermarkets where generic's distribution has reached 98% nationwide. Projected 1984 volume could exceed 30+ billion units. L&M currently sells 97% of all generic cigarettes.

In addition, R.J. Reynolds created the 25's segment in June, 1983 by launching Century. The brand is currently sold in about 70% of the U.S. and has attained a December, 1983 share of about 1.25% where sold.

Brown & Williamson quickly assessed 25's potential and launched RICHLAND in 20% of the U.S. in September, 1983. RICHLAND had about a .35% share in December, 1983 where sold.

Most recently, in February, 1984, a third price point has been created: Quik Trip Convenience Markets introduced Bronson cigarettes, manufactured by L&M and distributed exclusively by National Products Group. Carton pricing is about 11% more than generics and 13% less than branded 20's. Since this introduction is still in its first month and limited to

one regional chain, it is too soon to assess its viability or potential.

Recent market phenomena – generics' success, 25's introduction, mid-priced offer testing and increasing price discounting – indicate multiple price points will play a significant and increasing role in U.S. cigarette marketing.

To respond to these changing market conditions, Brown & Williamson is developing plans for each component of the emerging economic segment. A go/no go decision for RICHLAND expansion is expected in April, 1984. An analysis and recommendation of B&W's response to the creation of a mid-price point will be completed by March 26.

This document specifically addresses generics, which represent B&W's most immediate incremental volume opportunity.

II. Background

Total industry volume is declining – from 626 billion units in 1981 to 595 billion units in 1983. By 1988, B&W forecasts industry volume will decline to 591 billion units.

Counter to the general market trend, generic sales are growing rapidly. From a launch year volume of only 230 million units in 1980, generics have grown to over 17.5 billion units in 1983, approaching a 3% share of market. Currently generics are selling at an annualized rate of 3.56%. By 1988, using a straight line projection of generics' 1983 growth rate, generics will account for over 14 share points; more than 85 billion annual unit sales.

B&W's contribution to generics is disproportionately high. Specifically, B&W contributes about 70% more

than its fair share volume to generics. B&W losses account for about 21% of generics' gains. In 1983 B&W lost about 3.7 billion sticks to generics, a variable margin loss of over \$50MM. By 1988, this loss could total 18 billion sticks and about \$350MM lost variable margin.

Unchallenged, L&M could continue its total dominance of this segment and grow to a total company share of over 15% by 1988, becoming the third largest company in the U.S. cigarette market.

Stipulating that the industry's interests – other than L&M's – would be far better served had generics never been introduced, they are an immediate and growing threat to all other manufacturers. Competitive counter-actions are essential and inevitable.

III. Competitive Response

Generic growth represents volume erosion for all competitors. Unchallenged, L&M will continue aggressive segment development since it has virtually no stake in the branded, full price market.

All other manufacturers face a shrinking industry and eroding share and volume as generics grow. One or more competitors, particularly Philip Morris, R. J. Reynolds and Brown and Williamson, have the capacity, sales resources and motivation to participate.

1983 Losses to Generics

For perspective, in 1983 cigarette companies lost approximately the following volume and variable margin to generics:

* * *

These numbers/trends suggest that competitive response is inevitable and will be significant. Further, *all manufacturers currently have excess capacity available*. By company, we hypothesize the following anticipated competitive actions:

1. *R. J. Reynolds*

In terms of total volume and variable margin lost to generics, RJR is the most vulnerable company now and in the future.

Further, RJR has no brand currently able to replace these lost sales; no established RJR brand grew in 1983. Barring a major new brand success (Sterling or other) or an unforeseen turnaround of an existing brand(s), RJR must assault the economy segment to hold share and volume. In response to generics, RJR may pursue one or more of the following strategies:

Priority One

Launch a generic product line to gain control of and contain generic segment growth. RJR would strive to limit segment development since incremental generic growth will disproportionately reduce RJR's total margins.

Priority Two

Launch a mid-priced brand. This is a RJR's second best option given its:

- a) Sales force size and strength
- b) Domination and control of retail display fixtures
- c) Available list of low volume brands

These resources position RJR to distribute and sustain a mid-price at retail.

Priority Three

Increased discounting of RJR's full line of branded products in an attempt to reduce outflows to generics.

Priority Four

Continue and intensify development of the 25's segment through:

- Century support
- additional 25's brands
- shift to 250's cartons

While RJR may pursue this strategy, the source of business for 25's is currently branded, not generics products. Increased support of 25's does not therefore represent a direct, effective defense against generics' growth.

2. *Philip Morris*

Given the strength of their branded products, P.M. could choose to stay out of the economy segment and still maintain and increase its hold on industry share leadership.

However, P.M. may choose to maximize their total volume and share through the following strategies:

Priority One

Launch a generic product line directly competitive to L&M. P.M.'s low vulnerability to generics makes a direct entry attractive as a means to build net incremental volume with disproportionately low cannibalization while inflicting heavy losses on all other competitors, especially RJR and B&W. If P.M. enters generics, they have little reason to restrain segment expansion in the short term.

Priority Two

Launch a mid-priced brand using P.M.'s sales force strength – as can RJR – to establish and maintain a third price point.

Priority Three

Launch a 25's brand. As indicated in the RJR section, 25's are not a direct defense against generics. We, therefore, expect P.M. to track 25's growth and enter the segment when its trend justifies entry on its own merits.

Note: We do not expect P.M. to pursue established brand discounting given their brands' image-driven vitality and P.M.'s stated dismissal of such tactics for other than new products.

3. *American and Lorillard*

For several and different reasons, both companies contribute less than their fair share to generics. Both companies' parents are pursuing cash flow maximization strategies from their tobacco holdings to fund other activities.

However, both companies could, like P.M., choose to enter generics as a source of immediate low risk incremental volume.

Despite their conservative current marketing practices, both Lorillard and American will, along with the rest of the industry, be forced into generics competition in some form if the segment continues on current trend towards 14.5 50M in 1988.

IV. *B&W's Objective and Strategies**Objectives:*

Enter the generic segment to recover lost volume without negative trading profit impact. This objective will be pursued until such time as new branded products are launched and able to replace generic sales with higher margin volume.

1984

Obtain at least 3.7 billion generic unit sales this year.

Strategies

1. Offer an equivalent line of generic cigarettes at a lower net price to displace L&M as the principal generic supplier to select high volume trade customers.
2. Launch total offer in third quarter 1984 to gain volume and establish an immediate trade customer base. If generics grow towards 14.5 50M in 1988, B&W cannot afford to let other major competitors establish segment presence and preempt our future ability to generate volume from generic sales.

V. Summary Rationale

Generics represent B&W's most immediate opportunity to increase volume. This volume can be achieved within current manufacturing capacity, without incremental manpower and without negatively impacting trading profit. No other option offers similar potential to recover lost volume/share with such minimal investment risk. This is true because our goal is to capture existing demand . . . not create new consumer demand.

VI. Generic Business Plan

Implementation strategies for 1984 have been designed to meet this objective without seriously diverting resources from projects with higher trading profit potential. When higher margin branded products become available, B&W will proportionately reduce its generic sales.

1. *The target customer universe is the top 38 accounts.* While all direct-buying customers are potential candidates for the B&W generic entry, this primary target customer list represents an estimated 8.2 billion generic units per annum (4.18, last 6 months of 1984).

When combined with the 1 billion units available in Military commissaries (the initial Military target group), this select customer list can provide sufficient volume for successful entry into the generic segment.

In addition, this strategy will minimize:

- sales force effort
- the number of generic labels

2. *The product line will match competitive offerings style-for-style.*

B&W's generic products will basically match current national brand specifications to enhance production efficiencies. Most, if not all required plant modifications are already covered by the Macon Export Plan.

To match competition, these styles will be offered:

<u>Ultras</u>	<u>Lights</u>	<u>Plain</u> (Military only)
NM-KS	NM-KS	70
-100	-100	KS
	M-KS	
	-100	

This strategy calls for minimizing the number of labels required to meet the needs of B&W's priority high volume customers. These minimum requirements include: four black & white generic labels; three reserved for the highest volume customers in each area. Private labels, if any, will be copied as they are the property of targeted customers. The initial Military offering will be one of the above generic labels, but we are prepared to introduce a branded generic (e.g., "Hallmark") if required to gain entry into this important customer segment.

3. *B&W generics will be sold at the same list price, but with superior net costs to the customer.*

The list price will be \$18.75/M for Kings and \$19.75/M for 100's. No returned goods will be accepted.

B&W will offer a five level volume discount structure (range: \$.35/carton to \$.15/carton);

the competition's current offer has a more narrow \$.15 - .10/carton range.

Various other allowances are offered by the competition and will be met or exceeded on a selective basis. Here is a comparison of the discount/allowance structure:

	Per Carton Discounts			
	L&M		B&W	
	High	Low	High	Low
Total discount allowances:	\$.37	\$.22	\$.47	\$.27

Brown & Williamson's offer will produce a full variable margin of \$4.64/M and a net variable margin of \$4.14/M¹. B&W is prepared to spend up to net variable margin as a first step response to competitive counter-offers; if required, we are also prepared to go up to, but *not* beyond, full variable margin to gain entry into the generics market.

* * *

Financial Impacts

To attract customers, B&W is prepared to provide total discounts and allowances superior to competition.

These discounts and allowances can absorb all generic variable margin *except* that required to cover incremental overhead and working capital costs.

¹ The \$0.50 difference between full and net variable margin represents incremental overhead.

Longer-term, generics may become profitable. At this time, however, B&W is not projecting any profit or return from generics because the magnitude and duration of competitive response cannot be accurately estimated.

From a financial perspective, this proposal can be fully justified on the basis of its optimization of our manufacturing capabilities, its ability to carry its appropriate share of overhead, its assurance that financial losses on generics will not occur, and its ability (particularly if B&W's presence displaces L&M and/or preempts other competitors) to slow our branded, high margin losses to generics.

VIII. *Liggett and Meyers [sic] Response*

In the absence of direct competition, Liggett and Meyers [sic] will continue to develop the generic category. When any cigarette competitor enters the generic category, L&M will almost certainly react vigorously.

To survive a competitive entry, L&M can be expected to minimally match the competitive offer, at least in the Military and their largest volume accounts. Further, L&M may spend down to full variable margin (i.e., zero profit). Conservatively accepting that generics will attain about 24MM units in 1984, of which L&M might secure 20MM, it would cost L&M an additional \$35-45MM in lost variable margin to defend its business (assuming a competitor entered in June and Liggett defended in the 3rd and 4th quarters first by matching and then by going to a zero profit position).

It is also likely that L&M will consider a number of tactical moves, including:

- improving customer service by providing direct sales support

- adding code dating to improve product quality/aging tracking on the shelf
- line extending into full taste (including a KOOL-type menthol)

Brown & Williamson would be prepared to match any improvement in service level or line extension. If L&M goes below full variable margin, Brown & Williamson would not plan to match their offer. We would not expect L&M to be able to maintain a loss position for any extended period of time.

Note that any moves by L&M to augment sales support in the Military would necessarily drain resources from its civilian operations.

IX. *Industry Response to B&W Generic Entry*

If B&W launches a generic entry, we believe the most likely competitive response is a company-by-company re-evaluation of their respective plans for the economy and Value-for-Money segments. In the case of R. J. Reynolds and Philip Morris, the most likely candidates for entry, B&W's entry would force re-evaluation and reprioritization of their options (e.g., generic versus 25's versus mid-price point) and their timing of any planned introduction. Specifically, B&W's generic strategy will reduce any anticipated profit potential generics now offer. To gain a competitive advantage, competition must reduce margins further or divert key resources such as sales force time from higher margin established brands.

X. *B&W Response to an R.J. Reynolds or Philip Morris Generic Introduction*

A generic entry for Brown & Williamson whose purpose is to recover lost volume until such time as full margin new products can be launched makes

sense irrespective of whether R. J. Reynolds, Philip Morris (or both) introduce a generic either in response to B&W or before B&W. Specifically:

R. J. Reynolds or Philip Morris follow B&W into Generics

In this case, B&W is in a good position to retain much of the generic volume it has gained. This is because we are prepared, through various discounts, to spend down to full variable margin (zero profit) and RJR/PM should not be able to make their offer meaningfully more attractive since they are probably unwilling to risk selling below cost which in many situations would be evidence of unlawful conduct. (Law [. . .]

REDACTED

RJR or PM may have some flexibility to offer deeper discounts than B&W due to cost efficiencies in their operation which, if they exist at all, probably would trace to the use of offshore leaf. However, we judge that any such cost differential would be relatively minor and would translate to small enough variation in our and competitive discount structure so as to make the trade disinterested in going through the burden of changing generic suppliers.

Note that if RJR or PM take other steps, such as improving generic customer service, line extending, offering a returned goods policy, etc., we would be prepared to competitively match any such tactical move.

RJR or PM introduce generics before B&W

Under this scenario, B&W would move to enter the generic segment as soon as possible and be prepared to spend up to full

variable margin, targeting to gain as much large customer business as possible.

XI. Next Steps

This recommendation requests approval to initiate key trade customer contacts as the first step towards a third quarter launch. These contacts are essential to confirm our generic segment analysis and to assess our program's *incremental* sales generation potential.

If we find in this process unanticipated problems or if market conditions shift significantly, B&W will reconsider and modify this proposal as required. With these caveats, B&W can be prepared to enter the generic segment in the third quarter, 1984.

REDACTED

[Handwritten note]

current 1092 [illegible] ^{file}

MEMORANDUM

TO: I. W. HUGHES
J. ALAR
W. L. DeWITT
T. E. SANDEFUR

FROM: J. A. McDONOUGH

SUBJECT: 1984 STRATEGIC PLAN AND 10 YEAR FORECAST

DATE: MARCH 9, 1984

Attached is your copy of the 1984 Strategic Plan and 10 Year Forecast and cover letter to Mr. McCarty.

/s/ J. A. McDonough
J. A. McDonough

attachment

/mjs/1833J

* * *

B&W

BROWN & WILLIAMSON TOBACCO CORPORATION
1984 STRATEGIC PLAN
AND 10 YEAR FORECAST

RESTRICTED

FEBRUARY 1984

* * *

For American, a generic launch represents a relatively low cost, low risk source of incremental volume.

Although its parent company has been pursuing a strategy to maximize cash flow, American could be forced or decide to enter the economy segment. However, over the longer term, increased tobacco industry competition and higher resulting support levels could cause American to pursue a more aggressive cash maximization/sale approach.

Loews

Loews appears required to continue to use its tobacco business to somewhat insulate its corporate portfolio from earnings declines in other lines of businesses. Continued financial restructuring of Loews and potential sales of some non-tobacco property and businesses would be expected in 1984. Potential lower future industry profit margins and an improved U.S. economy, could imply that Lorillard could adopt a harvesting strategy.

However, for Lorillard, generics would represent a potential source of additional volume which would afford minimal risk to their established brands and require limited resources. They, like American, could be forced or decide to enter the generic market in some form if the segment continues its current trend.

Liggett & Myers

L&M's dramatic success with generics, combined with significant cost reductions over the past several years, has bolstered L&M's confidence to expand new branded product activities, although within a narrowly segmented approach. It would be estimated that L&M's future success and volume of activity in branded products will be

established using specific financial criteria. L&M can possibly husband its allocated funds by the elimination or recombination of duplicate Gary Tobacco activities as generics are a firmly established cigarette segment. Most recent announcements of a potential leveraged buyout of L&M would imply that L&M's new owners would be significantly more dependent upon generic/private label cigarettes for the company's viability.

In the absence of direct competition, Liggett & Myers will continue to develop the generic category. When any cigarette competitor enters the generic category, L&M will almost certainly react immediately and vigorously. However, it is unlikely L&M can, in fact, be prepared to engage in a sustained battle because it does not have the financial resources of others in the industry.

BROWN & WILLIAMSON TOBACCO CORPORATION

INTERNAL CORRESPONDENCE

TO Dr. I. W. Hughes
 DEPT. Mr. T. E. Sandefur, Jr.
Mr. J. Alar

C.C. to Mr. J. McDonough
 " Mr. C. Heger
 " Mr. D. Falk

FROM Mr. R. A. Blott

DATE March 22, 1984

SUBJECT Eric Bruell's Telex Dated March 21, 1984

This will address the questions raised by Eric Bruell with regard to our generic proposal. Before getting into specifics, however, it should be noted that Eric's overall conclusion was contingent upon gaining more knowledge on the LIFO effects of the recommendation. Carl Heger has concluded that the sale of 6 billion units of generics in 1985 and beyond would eliminate all LIFO decrements between 1984 and 1988. This would represent \$19 million if we included forecasted new products and \$81 million if excluded new products (see attached memo).

Now for the specific questions.

1. *Projected Growth Rate of Generics*

We do not believe this is a substantive issue. The fact is that we have already lost significantly on a volume and margin basis; we continue to lose disproportionately and that we can expect these losses

to continue if generics achieve *any* kind of future growth. We can abate these losses – certainly in a volume and share sense, and, to a limited degree in a financial sense, by an absorption of overhead and a modest return in generics simply by participating in the volume generics have already achieved.

Setting these views aside, we are preparing estimates of impacts assuming generics only grow to 7% of total market by 1988 (vs. 14%) and B&W's losses are 1.3 x fair share and 2.0 x fair share (vs. 1.7x).

2. *B&W's Entry Will Increase Total Generics And Might Provoke Competitor Reactions.*

The future growth of generics will be driven by consumer demand – not by the number of manufacturers who supply those products. The level of consumer demand will be a function of the price/value relationship, the image reinforcement needs of smokers and the level of retail distribution.

The B&W proposal is based on offering greater discounts – not reducing the list price. Since retail pricing is based on list prices, B&W's generics will not enhance the price/value relationship of present generics.

On the image front, there are obviously a certain number of smokers who are prepared to make the trade-off and they will do so irrespective of B&W.

On the distribution side, generics are already available in 98% of all commodity grocery volume and in approximately 65%-70% of all commodity cigarette volume. Future distribution gains will be limited and slow in coming. Further, B&W proposes selling against accounts already selling generics, thus displacing L&M.

As for provoking a competitive response from L&M or others, we suggested this was quite likely in our proposal. The decline in consumption and the growth in generics has removed 60 billion cigarettes from branded manufacturers in just three years. A competitive response appears to be inevitable and we strongly feel B&W will be better off being second rather than third or fourth.

3. *B&W's Credibility Will Suffer. This Initiative Will Conflict With Intention To Create Image As Leader In Innovation.*

Credibility is based upon the development of a successful business. One could argue that B&W's entry into generics could be viewed very positively – both in the sense of being aggressive in recapturing volume and in the sense of identifying an emerging segment and moving forcefully to establish a position in the new segment.

Innovation can come on many fronts – product, packaging, pricing, marketing, etc. Entry into generics with a strong program seems to be more innovative than letting a new segment emerge and get away from us.

4. *Financial Implications Of Generic Entry Need To Be Spelled Out And Compared To No Action. 25's/250's And Establishing A New Price Point.*

As noted previously, determining the financial implications of various scenarios is underway. Under any set of assumptions, the question of losing by not participating is not the issue – rather, it is determining the amount of the loss.

[Illegible]

[March 22, 1984.
See Tr. 47:33]

This will address questions raised by Eric Bruell with regard to our generic proposal. Before getting into specifics, however, it should be noted that Eric's overall conclusion was contingent upon gaining more knowledge on the LIFO effects of the recommendation. The Five Year Plan projects LIFO decrements of \$11.2 million in 1984 and \$7.8 million in 1985. Finance has advised that the sale of 4 billion units in 1985 would eliminate the decrements entirely.

Now for the specific questions.

1. *Projected Growth Rate of Generics*

We do not believe this is substantive issue. The fact is that we have already lost significantly on a volume and margin basis; we continue to lose disproportionately and we can expect these losses to continue if generics achieve *any* kind of future growth. We can abate these losses – certainly in a volume and share sense, and, to a limited degree in a financial sense, by an absorption of overhead and a modest return in generics simply by participating in the volume generics have already achieved.

To demonstrate this impact, Finance has computed Trading Profit under four scenarios. Two scenarios assume generics stay at 5% share (January, 1984 level) and B&W's diversion declines to 1.3x its fair share or grows to 2.0x its fair share (current is 1.7x). The last two scenarios assume generics grow to only 8% of the market with the same diversion ratios (1.3x, 2.0x).

The following tables summarize the results.

Generic Impact on B&W Trading Profit
Assuming B&W Does Not Enter

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Generics @ 5.0%					
1.3x Annual	(49.3)	(52.0)	(54.3)	(57.7)	(59.4)
Cume	(49.3)	(101.3)	(155.6)	(213.3)	(272.7)
2.0x Annual	(75.6)	(81.1)	(84.7)	(88.0)	(90.6)
Cume	(75.6)	(156.7)	(241.4)	(329.4)	(420.0)
Generics @ 8.0%					
1.3x Annual	(49.3)	(67.7)	(87.4)	(92.3)	(95.3)
Cume	(49.3)	(117.0)	(204.4)	(296.7)	(392.0)
2.0x Annual	(75.6)	(105.3)	(135.0)	(141.3)	(146.9)
Cume	(75.6)	(180.9)	(315.9)	(457.2)	(604.1)

This clearly demonstrates the impact of generics upon B&W. If generics just maintained current share (5.0%) and B&W's diversion declined to 1.3x fair share (which is highly unlikely), the loss in trading profit is \$272.7 million over the next five years. Any increase in generic share or diversion severely increases the impact on B&W.

2. *B&W's Entry Will Increase Total Generics and Might Provoke Competitor Reactions.*

The future growth of generics will be driven by consumer demand – not by the number of manufacturers who supply those products. The level of consumer demand will be a function of the price/value relationship, the image reinforcement needs of smokers and the level of retail distribution.

The B&W proposal is based on offering greater discounts – not reducing the list price. Since retail pricing is based on list prices, B&W's

generics will not enhance the price/value relationship of present generics.

On the image front, there are obviously a certain number of smokers who are prepared to make the trade-off and they will do so irrespective of B&W.

On the distribution side, generics are already available in 98% of all commodity grocery volume and in approximately 65%-70% of all commodity cigarette volume. Future distribution gains will be limited and slow in coming. Further, B&W proposed selling against accounts already selling generics, thus displacing L&M.

It is doubtful that B&W would lose more of its smokers to a B&W generic since manufacturers of generics would be loath to identify their company on the generic packs. As noted above, B&W would displace the current generics at retail – not sell along side current generics.

As for provoking a competitive response from L&M or others, we suggested this was quite likely in our proposal. The decline in consumption and the growth in generics has removed 60 billion cigarettes from branded manufacturers in just three years. A competitive response appears to be inevitable and we strongly feel B&W will be better off being second rather than third or fourth.

L&M will attempt to retain this business but lacks financial strength to cover all fronts on a sustained basis.

3. *B&W's Credibility Will Suffer. This Initiative Will Conflict With Intention To Create Image As Leader In Innovation.*

Credibility is based upon the development of a successful business. One could argue that

B&W's entry into generics could be viewed very positively – both in the sense of being aggressive in recapturing volume and in the sense of identifying an emerging segment and moving forcefully to establish a position in the new segment.

Innovation can come on many fronts – product, packaging, pricing, marketing, etc. Entry into generics with a strong program seems to be more innovative than letting a new segment emerge and get away from us.

4. *Financial Implications Of Generic Entry Need To Be Spelled Out And Compared To No Action, 25's/250's And Establishing A New Price Point.*

The financial implications of not participating in generics were described earlier. Finance has run two scenarios with B&W participating. The first assumes generics grow to 5% and B&W enters in 1984 and captures 50% of this segment by 1986. The second assumes generics grow to 8% with the same entry and capture ratio by B&W.

Trading Profit Impact
B&W Enters Generic Market

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Generic 5.0%					
Annual	(9.3)	(27.0)	(57.0)	(69.0)	(81.2)
Cume	(9.3)	(36.3)	(93.3)	(162.3)	(243.5)
Generic @ 8%					
Annual	(9.3)	(44.7)	(91.1)	(110.5)	(129.6)
Cume	(9.3)	(54.0)	(145.1)	(255.6)	(385.2)

Brown & Williamson Tobacco Corporation
INTERNAL CORRESPONDENCE

TO: E. T. Parrack

CC: T. E. Sandefur D. P. Christensen
R. A. Blott D. J. Bores

FROM: D. I. Falk DATE: April 26, 1984

SUBJECT: *Generic "Black and White" and Private Label Offerings Versus Branded Generic Offering*

This provides the pros and cons for two potential Brown & Williamson price offerings:

- *Generic "Black and White" and Private Label Offerings*
 - Brown & Williamson would offer an equivalent line of generic cigarettes to L&M at the same list price but at a lower net price (via greater merchandising and volume discounts).
- *Branded Generic Product (code name Hallmark)*
 - Brown & Williamson would offer a branded generic line-up (e.g., full taste and lights Ks and 100's, menthol and non-menthol) at the same list price as L&M. Instead of merchandising and volume discounts, the brand would be supported with B&W advertising and promotion.

Summary – The following page summarizes the pros and cons of these two propositions. This is then followed by a more detailed discussion.

Generic Comparison

"Black & White" and Private Label

- Pros
1. Greatest immediate volume opportunity
 2. Better limit generic segment cannibalization of B&W branded volume
 3. Requires no investment spending
 4. Superior short-term financial proposition
 5. Merchandising/returned goods responsibility shifted to the Trade
 6. Greater manufacturing overhead absorption/flexibility

Cons

1. May produce major competitive response (particularly L&M)
2. More difficult from a manufacturing standpoint (number of iterations)
3. Possibly greater legal risks
4. Not certain that can displace L&M
5. No initial load-in

Branded Generics

- Pros
1. From a volume standpoint, more latitude to go after full taste segment
 2. Has dual appeal of low price plus imagery
 3. May provide a quality reassurance
 4. Consumers can find the same brand in all outlets (not possible with "Black and White" generics where there are four variations)
 5. Has greater advertising and promotion opportunities
 6. Easier to manufacture (because less variations)
 7. May be more defensible competitively
 8. Initial pipeline volume

Cons

1. No guarantee of retail price level
2. Will require considerable investment spending
3. Could accelerate price segment growth and therefore cannibalization
4. Proposition of branded quality at generic pricing may not be believable
5. More difficult to secure merchandising
6. Return goods B&W responsibility
7. May be difficult to sell to chains which have own private label

Details

I. Generic "Black and White" and Private Label

A. Pros

1. *This appears to represent the greatest immediate volume opportunity for Brown & Williamson in the price segment.*
 - This segment has already proven its viability, with 1983 sales of over 17.5 billion sticks (3.0 share points). Alternatively, branded generics are at this time a basically untested idea.
2. *This proposition provides Brown & Williamson with the best opportunity to contain cannibalization of its full revenue branded products.*
 - B&W sales would replace current L&M generic volume and not be incremental, based on the assumption that the retailer need carry only one generic line since there would be little or no differentiation among different lines. Therefore, while cannibalization would still exist, it would be less than with a branded generic which would tend to increase the price segment.
 - Managing cannibalization is key since B&W has been losing disproportionately to generics (170 index versus fair share loss).
3. *This proposition requires no investment spending to be successful.*
 - Because we would be seeking to displace Liggett as opposed to building totally

new incremental volume within the industry, there would be no need to promote or advertise heavily to the consumer.

4. *This represents a more attractive financial proposition to the Company, at least in the short term.*

- Since "Black and White" plus private label generics do not require investment spending, the proposition pays out immediately and continues to pay out as you go.

5. *Due to the fact that "Black and White" and private label generics are basically the retail trade's product, they have the added benefit of transferring merchandising and returned goods responsibility to our customers.*

- B&W Sales Force involvement will be limited.
- There may be the added benefit of improved trade relations (and benefits to our branded line) to the extent that customers conclude that we are providing them a service (by producing their generic product).

6. *This proposition allows B&W the most flexibility in managing its manufacturing capacity because we can target customers initially since they are under contractual arrangements.*

- A branded generic offers less initial manufacturing flexibility because it will be

non-contractual and therefore not targeted [sic], and will be treated by the trade as a normal list item.

- This flexibility is also key assuming B&W wants to diminish its generic business at some future date (as more full revenue brands are available). It would be easier to manage down generic volume with accounts selling "Black and White" product under contract, than it would be to dial down branded generic volume sold in non-contractual outlets.

B. Cons

1. *This proposition may elicit a stronger competitive response than branded generics.*

- From the perspective of L&M, we would be competing directly with the major part of their total business. If a price war erupted - and if lower prices were passed on to the consumer, widening the price gap between generics and premium cigarettes - there is the possibility of increasing cannibalization.
-

4/30/84

Attached is the telex which is being forwarded to London.

I. W. H.

* * *

R.J.R. DORAL INTRODUCTION

Previous reports forwarded were the news wire release dated 4/27/84 and the investment community report entitled *Doral Backgrounder*.

This report covers verbal feedback from various trade factors based on their calls to R.J.R. To the best of our knowledge, presentation to the trade begins tomorrow (5/1/84).

1. The list price for KS will be \$18.75. This is comparable to Liggett's generic pricing.
2. There will be some form of volume rebates, but the exact amounts have yet to be determined. It would appear that the volume rebates will be proportional or somewhat greater than Liggett.
3. The terms are 3.25%, 30 days. This is standard introductory terms and whether or not the 30 days will remain permanent is yet to be seen.
4. 12 states have been identified so far and are as follows: Ohio, Kentucky, Indiana, West Virginia, Kansas, Arkansas, Pennsylvania, North Carolina, South Carolina, Tennessee, Virginia and Mississippi. One of our customers was advised that these twelve states will represent 40% of the generic volume.

Additional information will be forwarded as quickly as it becomes available.

4/30/84

RAB/eah

DATE: May 1, 1984

SUBJECT: *Generic "Black and White" and Private Label Offerings Versus Branded Generic Offering*

This provides the pros and cons for two potential Brown & Williamson price offerings:

- *Generic "Black and White" and Private Label Offerings*
 - Brown & Williamson would offer an equivalent line of generic cigarettes to L&M at the same list price but at a lower net price (via greater merchandising and volume discounts).
- *Branded Generic Product (code name Hallmark)*
 - Brown & Williamson would offer a branded generic line-up (e.g., full taste and lights Ks and 100's, menthol and non-menthol) at the same list price as L&M. Instead of merchandising and volume discounts, the brand would be supported with B&W advertising and promotion.

Summary - The following page summarizes the pros and cons of these two propositions. This is then followed by a more detailed discussion.

Generic Comparison

"Black & White" and Private Label

- Pros
1. Greatest immediate volume opportunity
 2. Best opportunity to limit generic segment growth and cannibalization of B&W branded volume
 3. Requires no investment spending
 4. Superior short-term financial proposition
 5. Merchandising/returned goods responsibility shifted to the Trade
 6. Greater manufacturing overhead absorption/flexibility

Cons

1. Potential competitive response
2. Manufacturing complexity (many styles)
3. Legal risks
4. Not certain that can displace L&M

Branded Generics

- Pros
1. Has dual appeal of low price plus imagery
 2. May provide a quality reassurance
 3. Consumers can find the same brand in all outlets (not possible with "Black and White" generics where there are four variations)
 4. Manufacturing simplicity (four styles)
 5. May be more defensible competitively

Cons

1. No guarantee of retail price level
2. Requires heavy investment spending
3. Low potential to return growth of generic segment
4. Proposition of branded quality at generic pricing may not be believable
5. Difficult to secure distribution and merchandising expensive
6. Return goods B&W responsibility
7. May be difficult to sell to chains which have own private label

Details

I. Generic "Black and White" and Private Label

A. Pros

1. *This appears to represent the greatest immediate volume opportunity for Brown & Williamson in the price segment.*
 - This segment has already proven its viability, with 1983 sales of over 17.5 billion sticks (3.0 share points). Alternatively, branded generics are an untested idea.
2. *This proposition provides Brown & Williamson with the best opportunity to contain cannibalization of its full revenue branded products and limit segment growth.*
 - B&W sales would replace current L&M generic volume and not be incremental, based on the assumption that the retailer need carry only one generic line since there would be little or no differentiation among different lines. Therefore, while cannibalization would still exist, it would be less than with a branded generic which would tend to expand the economy segment.
 - Managing cannibalization is key since B&W has been losing disproportionately to generics (170 index versus fair share loss).
 - Direct competition with L&M will force them to defend their current business,

reducing funds available to support further business-building.

3. *This proposition requires no investment spending to be successful.*
 - Because we would be seeking to displace Liggett as the source to existing generic business, there would be no need to promote or advertise heavily to the consumer.
 4. *This represents a more attractive financial proposition to the Company, at least in the short term.*
 - Since "Black and White" plus private label generics do not require investment spending, the proposition pays out immediately and continues to pay out as you go.
-

MEMORANDUM

May 2, 1984

TO: D. I. Falk

FROM: Jim Hite

SUBJECT: COMPETITIVE ACTIVITY - DORAL

The following information has been obtained from the Bosart Co., Springfield, OH concerning Doral:

Product:	Doral Regular Kings and 100's Doral Menthol Kings and 100's
Manufactured by:	R. J. Reynolds
Date of Introduction:	May 11, 1984
Area of Introduction:	13 states (OH, KY, IN, WV, KS, AR, PA, NC, SC, TN, VA, MS, MO)
Price:	\$18.75 per M Kings \$19.75 per M 100's
Introductory Period:	May 11 - June 8
Introductory Discount Allowance:	\$9.60 per allocated 12M case. Allowance will be deducted from invoice.
Terms:	3 1/4% - 30 days

**NEW DORAL CHALLENGES
LOW-PRICED BRANDS**

[Handwritten Note]
Rec'd from Bert Trompter

**DIRECT ACCOUNT FACT SHEET
DORAL FILTER AND MENTHOL KING/100'S**

Product

New DORAL Filter and Menthol King 100's is the first established cigarette to be introduced as a low-priced brand. In contemporary packaging. DORAL will feature a rich blend and a standard filter, offering smokers a high quality brand name cigarette at a new low price.

Advertising

During the introductory period, an impactful newspaper advertising campaign will support the introduction of DORAL Filter and Menthol King 100's

Promotional Support

- DORAL will be featured prominently in supplemental package and carton displays.
- During DORAL's introduction, in-store merchandising will generate consumer awareness and trial

Introductory Discount Allowance

- \$9.60 payment per *allocated* 12M case of DORAL Filter and Menthol King 100's *purchased* during the introductory period.
- Terms: 30 days, 2% cash discount, 1 $\frac{1}{4}$ % anticipated allowance.
- Allowance will be deducted from invoice

Distribution Incentive Program

- Per case payment on all DORAL cases purchased and delivered during a calendar quarter

Cases per Quarter	Allowances per Case
0-99	\$1.80
100-199	\$3.00
200-299	\$6.00
300-399	\$7.20
400-499	\$8.40
500 Plus	\$9.60

- Incentive Case Allowance will be paid by check or credit memorandum on a quarterly basis

Production Information

	UPC					
	Case Size	Weight	Cube	12M Case	Carton	Pack
DORAL F. 85's	12M	30.0 lbs.	2.4	12300-15112	12300-15113	12300-00051
DORAL M. 85's	12M	30.5 lbs.	2.4	12300-15712	12300-15713	12300-00057
DORAL F. 100's	12M	35.1 lbs.	2.8	12300-15212	12300-15213	12300-00052
DORAL M. 100's	12M	35.6 lbs.	2.8	12300-15812	12300-15813	12300-00058

[In Evidence 5/4/84]

[Handwritten Notes]

[Illegible]

B&W STRATEGIESFOR ECONOMY CIGARETTES

[Handwritten Notes]

Black & Whites

[Illegible]

I. *Summary*

The economy segment continues to grow and expand. Generic sales now exceed four percent of industry, making them the seventh largest "brand." Based upon our present knowledge of the RJR launch of Doral at generic prices¹, it is now totally predictable that this segment will expand and grow. History, to date, indicates that the Doral action will enhance cannibalization of branded items, although it is clear that it is RJR's intention to narrow this effect to black and white or private label brands.

¹ Fourteen states and the military, representing 39% of total cigarette sales.

Given B&W's extreme vulnerability in this segment (170 index contribution versus S.O.M.), the company can expect further and increasing losses to economy propositions.

To counter this growing threat and to exploit the volume opportunities both unbranded and branded generics represent, B&W recommends immediate execution of two strategies:

- A. The first strategy is to displace L&M as the supplier of black and white/private label generics. This will be achieved by national introduction of generic (black and white and private label) styles comparable to Liggett's with superior selling allowances, therefore a lower net (not list) selling price. Plan of action to be followed is exactly as our previous proposal outlined.
- B. Launch Hallmark as a branded generic, following precisely the pathway of RJR. Consideration has been given to other brand names, including established brands. Established brands were

rejected due to financial penalties. The only other immediate option is Falcon and we do not own that mark in the USA.

This two-prong approach is required since neither strategy alone can effectively exploit the volume opportunities that branded and unbranded generics represent. This approach exploits all visible avenues for the foreseeable future.

II. Background

- A. Through March, 1984, generic share continues to grow and now exceeds 4.0% of the market.
- B. B&W's vulnerability to generics is the greatest of all companies: a 170 index to share.
- C. L&M's March, 1984 price increase (\$1.50/M) improves generic profitability making the segment more financially attractive to other manufacturers. This raises the probability of competitive entry. The key future player in black and whites is RJR-lack of success with Doral will undoubtedly lead to their launching a black and white.
- D. B&W has the capacity to supply new generic, private label and branded generic offers without any adverse affects on the key new product elements of the 5-year plan.
- E. RJR's announcement of Doral's repositioning adds volume potential to the economy segment by offering branded quality reassurance to low price positioning. Further, RJR's aggressive fixture merchandising program is designed to provide retail presence for Doral and will attempt to limit generic in-store presence. Doral will offer four low-tar styles: KS/100's in regular and menthol.

III. *Implications*

The Doral repositioning further expands the economy segment: a branded offer can attract price-conscious smokers who have rejected unbranded/private label generics if the retail price point can be maintained. The impact of [illegible] West price reduction in Germany indicates how much incremental share can be moved to low-priced brands by the addition of a branded line to unbranded generics if the price can be maintained. The German experience, plus our own work, show that low price branded offers do not replace unbranded volume: they draw new smokers to the economy segment.

To compete effectively, B&W must offer both unbranded and branded styles.

RJR's Doral repositioning will draw consumer attention to branded generics and create distribution for them. B&W can exploit this opportunity with Hallmark with minimal investment and taking advantage of RJR's consumer communication of the branded generic concept.

Immediate execution of both strategies provides the synergy required if B&W is to gain a meaningful level of participation in the economy segment, avoid further competitive preemption, and realize volume potential. In the area of competitive response, PM is rumored to be evaluating four fully-branded economy offers (three new trademarks and one existing brand).

The dual approach of the Hallmark and black and whites will give B&W the opportunity to gain greater participation in the economy segment. Longer term, this participation should provide B&W more influence to manage up the prices of branded generics to improve profitability.

It is also clear that all manufacturers must aggressively manage full revenue brand pricing to mitigate the profit impact of branded and unbranded generic growth.

In combination, these factors represent a major restructuring of the U.S. cigarette market dynamics.

IV. *B&W Program Summary*

A. Launch a full line of black and white and private label styles:

1. Same style array as L&M
2. Same list price
3. Superior discounts/allowances

B&W will be prepared to spend full margin in order to displace Liggett & Myers as the trade source of generic and private labels.

B. Launch four styles of Hallmark at generic price:

1. Same markets as Doral
2. Lights: regular, menthol, king, 100's
3. Same terms/allowances as Doral
4. Invest a portion of available margin to buy shelf space on RJR's Doral fixtures or existing generic fixtures and in-store merchandising support. No consumer-marketing effort planned.

V. *Financial Implications*

A. *Black and White/Private Label*

The B&W plan of being a supplier of black and white/private label generics is exactly the same as our previous generic proposal. Assuming 1984

and 1985 sales quantities of 2.2 billion and 15.2 billion, respectively, Trading Profit would be \$5.1 million for 1984 and \$43.6 million for 1985. However, in order to ensure customer participation and/or defend competitive counterattacks, B&W is prepared to redistribute this entire amount in the form of additional trade allowances. Exhibit I attached provides a summary of the financial implications and major assumptions.

B. *Hallmark - Branded Generics*

B&W's second strategy introducing Hallmark as a branded generic in four styles assumes a start ship date of August, 1984. Assuming sales of .7 billion in 1984 and 2.1 billion in 1985, there would be a break even position achieved at Trading Profit in 1984 and an estimated \$4.1 million Trading Profit in 1985. Exhibit II attached provides a summary of the financial implications and major assumptions.

C. *Impact of Doral on B&W*

As noted previously, the Doral action will enhance cannibalization of branded products, and B&W can expect to contribute more than its current share of market. Assuming Doral eventually attains a 1.5% share of market and B&W contributes two times its share of market (22%), then B&W's lost sales quantities for 1984 and 1985 would approximate 300 million and 700 million respectively. The estimated reduction in Trading Profit would be \$3.7 million in 1984 and \$8.8 million in 1985.

BLACK AND WHITE/PRIVATE LABEL FINANCIAL ASSUMPTIONS

The current Generic proposition will be alike in every way to the original February proposition, with the exception the first ship date would be August, 1984 rather than June 1, 1984.

Projected Sales Volumes are as follows:

1984		1985			
Aug.	.12	Jan.	.74	July	1.40
Sep.	.25	Feb.	.80	Aug.	1.49
Oct.	.49	Mar.	.95	Sep.	1.53
Nov.	.62	Apr.	1.10	Oct.	1.55
Dec.	.68	May	1.20	Nov.	1.58
		Jun.	1.30	Dec.	1.60
Total	<u>2.16B</u>				<u>15.24B</u>
Use	<u>2.2B</u>				<u>15.2B</u>

Selling Prices assumed to be as follows:

1984 - assume no additional increases in 1984 from current 5/3/84 prices

Type	%	Price	Less Discount 2%	Net Price
Kings	51	18.75	.375	18.375
Longs	49	19.75	.395	19.355
Average	<u>100</u>	<u>19.24</u>	<u>.385</u>	<u>18.855</u>

1985 and Forward

Basis will be to assume the same relationship of Generic to Premium priced products that would exist in 1984:

	Kings			Longs		
	Full	Generic	%	Full	Generic	%
5/3/84 Gross	\$29.15	\$18.75		\$30.15	\$19.75	
Discount	3 1/4%	2%		3 1/4%	2%	
Net Price	<u>\$28.203</u>	<u>\$18.375</u>	<u>65.2</u>	<u>\$29.170</u>	<u>\$19.355</u>	<u>66.4</u>
				Assume <u>65%</u>		

[Handwritten Note]

Generics 5/15/84 London

Background

Prior to 1982, the Domestic U.S. cigarette market realized a compounded unit growth rate of 1.3% over a 10 year period. Total industry shipments increased from 549.9B in 1972 to 626.1B in 1981. Manufacturer's price increases generally were below the rate of inflation but margins improved handsomely due to favorable leaf prices and cost reductions associated with automation. For example, Brown & Williamson's variable margin increased from \$2.91/M in 1972 to \$8.78/M in 1981, an increase of over 200%. In 1982, the industry became much more aggressive on the pricing front, fueled by a 100% increase in the Federal Excise Tax. Brown & Williamson's variable margin increased from \$10.78/M in 1982 and to \$12.61/M in 1983.

The impact of these pricing activities on the smoking public was dramatic. The weighted average retail price of a pack of cigarettes increased 56% between 1980 and 1983 (from \$.63 to \$.98). These increases, in combination with the continued health controversy and a recession, led to a decline in industry shipments in 1982 to 622.3B (-.6%). Shipments declined more severely in 1983 to 595.9B (-4.2% versus 1982). Between 1981 and 1983 total industry shipments declined 30.2 billion units.

Emergence of Economy Priced Segment

Coincident with the above, the smallest of the Domestic U.S. manufacturers was on the verge of going out of

business. Liggett & Myers' share had declined to 2.33% in 1980 and none of its brands were progressive. However, seeing the margins which were available, L&M made the bold move of introducing a generic black and white package at a substantial price discount. While selling only 230 million units in 1980, L&M has expanded the business to over 4 share points in the first quarter of 1984.

L&M has built the generic business with a well thought-out and elaborate plan involving both distributors (black and white labels) and direct retail accounts (private labels). It is presently estimated that 80% of this business is in black and white offerings and 20% is in private labels.

This is the first time that a manufacturer has used pricing as a strategic marketing weapon in the U.S. since the depression era. At that time, when economic conditions were more severe than at present, low price brands captured approximately 23% of the market before the dominant manufacturers dropped their prices on full priced brands, thereby limiting the low price entries to 10%-14% market share during the 1930's.

Current Situation

L&M's successful development of the generics/private label segment has come from all manufacturers. However, Brown & Williamson has lost disproportionately and R. J. Reynolds has lost the most absolute volume as summarized below.

1983 Losses to Generics

	Contribution To Generics*	Fair Share Loss Index	Volume Loss (BB Sticks)	Variable Margin Loss** (\$MM)
American Brown & Williamson	7.0	(83)	1.28	16.3
Liggett & Myers	21.1	(170)	3.78	48.2
Lorillard	3.0	(120)***	.58	7.4
Philip Morris	8.0	(83)	1.48	18.9
R.J. Reynolds	22.7	(73)	3.98	50.7
Total	38.2	(118)	6.78	86.4
			17.88	227.9

*Based on Switching Study, Waves 34 & 35

** Assumes \$12.75/M Variable Margin

*** Excluding generics

Brown & Williamson's disproportionate loss is a function of the nature of its brand franchises. Brown & Williamson's smokers are generally older and more down-scale than the balance of the industry.

Given RJR's recent loss of industry leadership, its large and continuing losses to generics and its stated objective of regaining leadership through a product line strategy of having entries in all viable segments, it is not surprising that RJR has just launched the first branded generic. RJR is repositioning an established brand (Doral .2% SOM) and has introduced it nationally in the military and in 14 states in the civilian market. The list price of Doral in the civilian market is comparable to Liggett & Myers' generic and RJR has announced an aggressive merchandising program, superior discount structure and a newspaper advertising program. In the military, RJR has launched at a lower list price than generics (\$16.95/M versus \$18.25/M).

Strategic Conclusions

The RJR stated position in its announcement of its plans to introduce Doral at generic prices was to participate in the emerging economy price segment. A VICEROY pricing test was conducted in the military in 1983. The price of VICEROY was reduced to near generic levels and while volume increased 366%, virtually none of that business came from generics. Therefore, B&W believes that branded generics will enhance the growth of the economy segment and will draw volume from popular priced brands. B&W believes that the black and white/private label generics will continue to be a large and viable

subsegment of the total economy segment. Black and white's have an established trade and consumer franchise which delivers substantial profits to the retailers. In addition, private label retailers, who have resisted black and white cigarettes, will continue to resist branded generics in order to protect their labels and profits. As a consequence, several strategic conclusions can be drawn.

1. *The economy segment has established itself in the U.S. market and will be a major part of the market in the foreseeable future.*

U.S. consumers have demonstrated an increased propensity to smoke economy priced cigarettes and it is clear that to some smokers, price is more important than image. Further, while the financial penalty is severe, it is equally clear that two manufacturers find these margins acceptable, at least for the time being. (As a matter of perspective, the variable margins on generics today are better than those realized by the industry as recently as 1977.)

2. *A declining total market in combination with growth in the economy segment makes a strong competitive response inevitable.*

The decline of the total industry and the four share points captured by generic/private labels have reduced the number of units to branded manufacturers by over 50 billion per year.

3. *The future shape of the Domestic U.S. market will change dramatically as a result of the emergence of the economy segment.*

Cigarette manufacturers will either stay on the sidelines and accept the losses to economy offerings and attempt to limit future price increases in order not to fuel the growth of generics – or – they will enter the new segment in an attempt to participate in order to

manage prices and profitability upward. The latter appears to be the most predictable approach.

Private labels are expected to have a very long life cycle given the trade's interest in protecting its own brands. The long term staying power of black/white cigarettes is unknown but they are expected to be a significant factor in the near and intermediate term. It is quite likely that manufacturers will introduce branded generics, develop loyal franchises and then gradually raise prices over the longer term. Thus, the U.S. market could quickly become one of the multiple price tiers.

If the economy segment were to grow to 25 to 30 percent of the total market, manufacturers as a last resort may reduce list prices of full margin products in an attempt to repeat the action of the mid 1930's.

An additional impact could be reduced marketing support for full margin brands as manufacturers attempt to drive economy offerings and maintain bottom line profitability.

And finally, if all of this comes to pass, it could put in jeopardy a single focus strategy of full margin new products as the number of full margin brand smokers will decline as the economy segment grows.

4. *Brown & Williamson is the most vulnerable company to economy propositions.*

For the most part, B&W's portfolio of brands has a long history of decline (KOOL peak year - 1975, RALEIGH and VICEROY - 1966, BELAIR - 1969). The absence of inflows has resulted in an older and lower income franchise versus total smokers. It is these smokers that have been attracted to generics as outlined below.

Generic Smokers Indexed To Total Industry

Over 44	118
Less than \$15,000	158

The contribution B&W has made to generics is significant and has been increasing.

B&W Contribution to Generics

		<u>%</u>	<u>Fair Share Index</u>
1981	1st Half	10.5	74
	2nd Half	12.9	91
1982	1st Half	15.6	115
	2nd Half	17.9	133
1983	1st Half	23.2	181
	2nd Half	20.2	170

It is our firm conviction that branded generics, which are heavily advertised and promoted (with both price and image benefits), will have an even more devastating impact on Brown & Williamson.

Projected Future Impact of Economy Segment

To fully understand the impact of the economy segment upon various manufacturers in the future, a projection has been made assuming that:

1. The economy segment grows to 10% of market by 1988. It was further assumed that two-thirds of this segment would be represented by black and white/private labels and one-third branded generics.
2. That each company would continue to contribute at their 1983 rate (B&W's fair share index remains at 170

for black and white/private label but increases to 200 for branded generics).

The following summarizes individual company volume losses versus expectation if no economic propositions had existed.

Projected Volume Loss To Economy Segment
(Billions)

	1984	1985	1986	1987	1988	Cume
B&W	6.6	9.5	10.4	11.5	12.5	50.5
RJR	11.9	17.1	18.9	20.9	22.6	91.4
ATC	2.2	3.1	3.5	3.8	4.1	16.7
PM	7.1	10.2	11.2	12.4	13.4	54.3
LOR	2.5	3.6	4.0	4.4	4.7	19.2
L&M	.8	1.2	1.4	1.6	1.8	6.8
Total Loss to Economy Segment	31.1	44.7	49.4	54.6	59.1	238.9
Economy Segment Share of Market	5.2%	7.5%	8.3%	9.2%	10.0%	

Even if these projections are off by 20%-30%, it is clear that the effect of the economy segment is significant for all manufacturers.

Competitive Responses

RJR has clearly stated its willingness to live with lower margins on volume *it otherwise would not have enjoyed*. If RJR is successful with Doral, a second branded entry should be anticipated. Irrespective of the success of Doral, if black and whites/private label continue to grow, RJR may well enter that segment too.

Philip Morris will probably take a 'wait and see' approach due to its less than fair share contribution to the growth of generics. If Doral is successful, Philip Morris will probably launch a branded generic.

Lorillard is expected initially to take a 'wait and see' approach, again due to its less than fair share contribution. Nevertheless, B&W believes that based upon a knowledge of the Lorillard management, that Lorillard will be the next company to enter this segment and would most likely reposition Old Gold at the generic price point (presently .3% share of market).

American is not expected to respond given its history of being the last in the industry to recognize new consumer trends.

L&M is expected to match RJR's discount structure and the military price point. In addition, L&M seems to be in an ideal position to launch a branded generic and could reposition Chesterfield at a lower price point (presently .5% share of market).

Brown & Williamson's Present Position

The 1984 Five Year Plan assumed some impact from the economy segment albeit at a far less significant level. Recasting the Plan numbers is necessary using the following assumptions:

1. The economy segment grows to 10% by 1988 split two-thirds black and whites/private label and one-third branded generic.
2. Brown & Williamson loses volume at a 170 fair share index to black and white/private label and at a 200 fair share index to branded generics.
3. All other assumptions remain as stated in the Plan.

Thus, if Brown & Williamson chooses to stay out of the economy segment, i.e., do nothing, it will suffer the following losses, based on the foregoing assumptions.

	1984	1985	1986	1987	1988	Cume
Share Loss	- .5	- .9	-1.0	-1.2	-1.3	29.0
Volume Loss	-2.7	-5.4	-6.2	-7.0	-7.7	
Trading Profit Loss	(\$29.5)	(\$65.3)	(\$82.2)	(\$101.0)	(\$120.2)	(\$398.2)

Brown & Williamson Alternative Strategies

1. Utilize RICHLAND

A. Convert RICHLAND 25's to 20's at Generic prices.

Advantages

1. Some awareness and usage in 20% of U.S.

Disadvantages

1. Give up position in potential new segment.
2. Smoker confusion in current 20% of U.S.
3. No reason to believe RICHLAND better than other marks for economy segment.

B. Offer Richland 20's at Generic price in addition to current 25's offering.

Trade will not accept because of confusion in the market place.

2. Convert established brand to generic price point.

Advantages

1. Leverages existing awareness and heritage.
2. Immediate national presence and large consumer franchise.
3. Adds timing flexibility - could move now or later.

Disadvantages

1. Loss of significant trading profit.
2. Branded generics may not succeed - uncertain about maintaining price point, and no

ability to recapture full margin consumer acceptance.

3. Reversal of declining trend doubtful.

Of B&W's established brands represents the one which has been focused on as a potential first entry as it would allow B&W to leverage existing awareness and heritage, provide national presence and a large group of current smokers.

REDACTED

This option is not recommended at this time. The major concern is the risk of \$270MM of brand contribution over the Plan period, should the branded generic price point not be established broadly. In other words, should B&W drop the price and this not be reflected at retail, B&W will have succeeded in enhancing trade profitability without any resulting consumer benefit.

Nevertheless, this strategy will be readied for implementation in the event that the branded economy segment gains broad consumer acceptance and conversion of established brands to generic prices looks more viable.

3. *Enter Black and White/Private Label Part of Economy Segment*

Advantages

1. Potential for immediate volume improvement.
2. No investment spending.
3. Some profit contribution with potential for some margin improvement longer term.
4. Utilizes available production capability.

Disadvantages

1. Lack of brand ownership.
2. Shorter production runs.

4. *Introduce branded generic behind Doral*

Advantages

1. Takes advantage of RJR's leadership in establishing the price point.
2. Takes advantage of RJR's advertising and merchandising strategy.

Disadvantages

1. Not sure branded generic will succeed – with or without Doral. Uncertain about maintaining price point and distribution.
2. Draws from full margin smokers incremental.

Recommendation

The earlier concern of expanding the economy segment is no longer tenable, given RJR's recent action. It is clear that the economy segment is significant, and growing.

Accordingly, recognizing the importance of minimizing increased cannibalization and concomitant share erosion, as well as maintaining trade profit targets, it is imperative that B&W enter this segment. We propose the following program for entry:

1. Introduce a branded generic behind RJR and enter the black and white/private label segments nationally.

2. Limited marketing spending behind the branded generic relying on price and product quality as its consumer point of difference.
3. Take advantage of RJR's consumer advertising and merchandising to create awareness of branded generics.
4. Utilize an aggressive discount structure to obtain black and white/private label business.
5. Leverage the synergy of branded/black and white two-pronged approach by allowing branded generic sales to apply against the black and white discounts.
6. Longer term be prepared to reduce price on VICE-ROY if branded generics exhibit broad consumer appeal.

Marketing Approach

A. *Launch a full line of black and white and private label styles:*

1. Same style array as L&M
2. Same list price
3. Superior discounts/allowances

B&W will be prepared to spend full margin in order to displace Liggett & Myers as the trade source of generic and private labels, although not contributing, to trading profit, it will give us short term volume and share enhancement.

B. *Launch Hallmark at generic price:*

Every successful new cigarette brand has achieved consumer acceptance because it has

offered a unique selling proposition. The level of success is primarily dependent upon the manufacturer's ability to generate awareness and trial – this in turn is a function of the willingness to invest marketing funds and realize near term losses.

In the case of Hallmark, the unique selling proposition is price. The weighted average retail price of B&W's offering will be 22% less than 96% of all cigarettes sold today.

Another key factor contributing to Hallmark's success will be RJR's efforts at establishing and maintaining the new price point – a feat B&W would have been unable to accomplish alone.

Further, RJR's merchandising program will create a new home for branded generics. This new home will be away from the popular priced brands and will communicate the new price structure to in-store consumers. Having a position on this fixture with appropriate point-of-sale materials, etc. will communicate the same price story for Hallmark.

In the product area and based on a very limited evaluation of Doral, the product appears to be a very low cost design. The product is unusual having nearly equal proportions of lamina, reconstituted, puffed tobacco and longer filters. The high level of puffed tobacco and longer filter result in low tobacco weights, ranging from 70-120 mg/cigarette less tobacco. The high level of reconstituted provides a vehicle for using larger amounts of scrap tobacco or offshore leaf. The quality of the lamina is not known.

The recommended Hallmark non-menthol product has tested at parity versus Winston, Century

Lights and generics. The Hallmark menthol product has scored parity versus Salem, Benson & Hedges Lights and, superior to generics. Therefore, we believe the smoking characteristics of Hallmark should be superior to those offered by Doral.

The marketing approach would encompass entering the same markets as Doral with identical style offerings. This would include lights products at 14mm tar, regular, menthol, king and 100's. The terms and allowances would replicate RJR's. B&W's program would also encompass a policy of no return goods.

B&W would invest a portion of available margin, buying shelf space on RJR's special Doral fixtures and on existing generic fixtures and some in-store merchandising support including shelf talkers, window banners and riser cards. The primary communication objective of all point-of-sale would be price and superior taste/quality would be the secondary objective. Forced trial via sampling, coupons, etc. would be executed on a targeted basis.

Since the B&W plan uses limited spending against what is believed to be the Doral approach, it is realized that the Hallmark share growth will be slow.

Such a recommendation will provide a strategic response to the following considerations.

1. Economy propositions are fulfilling a real consumer need as demonstrated by their continued growth and acceptance.

2. Entering black and white, private label and branded generics gives B&W a representation in all subsegments of the economy segment. The lack of entry leaves B&W out of a segment which may become more financially attractive over the long term.
3. B&W's concern over expanding the economy segment is no longer a barrier to entry. RJR's launch of Doral and the continued growth of the other subsegments require us to respond to minimize future losses.
4. Entry and success in this new segment will not impede B&W's ability to maintain its new product program.
5. Retailers will protect their vested interest in black and white/private labels and both are expected to remain on the market in the foreseeable future.
6. Both black and white and private label entries are required as they are merchandised through different retail customers.
7. Contrary to our previous position, introduction of a branded generic by B&W now appears to be feasible as RJR has the clout and sales force coverage to maintain the price on branded generics.
8. Not [sic] investment spending behind a branded generic is risky and will result in a lower growth rate, but is considered appropriate given B&W's need to husband resources for better margin new products.
9. An aggressive discount structure on black and whites/private labels will be required to get trade factors to switch manufacturers. Having gained the business, B&W believes that it will retain much of it as competitors will not be able to make their proposals meaningfully more attractive without selling below cost. Competitive response of this nature would be considered unlawful conduct.

10. Allowing B&W's branded generic sales to count toward black and white discounts overcomes a major trade problem with RJR's entry and will encourage acceptance and distribution.
11. The cost of entering the new segment is minimal. Entry, however, provides B&W with the potential for improving profitability through opportunistic pricing, either to lead or to follow as appropriate.
12. By nature of the Hallmark offering, timing is essential. Should a competitor preempt Brown & Williamson, then the Hallmark proposition, which is based on acquiring shelf space, is severely jeopardized.

Financial Implication of Recommendations

If B&W can successfully achieve a 60% participation by 1988 in the black and white generics segment, it has the opportunity, with minimal investment, under the pricing assumptions incorporated in our Plan, to recapture 23 billion units of volume by 1988, an increase in market share of 4 share points by 1988 and aggregate potential trading profit from 1984-88 of \$342 million. This entry alone recoups the bulk of potential trading profit losses which could be expected by the virtue of a conscious decision to allow this segment to expand and be available to others. While it may require, to gain this business, the use of some or all of this potential trading profit, the expectation is that this segment can become more profitable, particularly as it approaches maturity.

In order to participate in the branded economy segment, B&W is recommending the introduction on a minimal investment basis of an economy brand, i.e., Hallmark

(This proposal assumes a certain cost for merchandising. If that cost is increased, then the proposal will be reappraised). If Hallmark achieves by 1988 a .6% share of market, a volume of some 3.6 billion units, B&W can anticipate, on assumptions consistent with those built into the Plan, to achieve trading profit of 30 million, in aggregate from 1984-1988, trading profit otherwise lost to competitors.

The combined strategy, then, of B&W entering the branded generic and the black and white/private label market, will over the five year period, based on the current forecasts, achieve both an incremental market share of 4.7%, and a volume of 27.3 billion in 1988. This enhances the probability of achieving the Plan trading profit.

LIFO Leaf Decrements

The impact of the proposed strategy on Plan LIFO Leaf decrements (in broad terms) is summarized in the following table:

	<u>LIFO Leaf Decrements</u> <u>Dollars In Millions</u>					<u>Total 1984- 1988</u> \$19.0 \$12.0
	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	
Plan Decrements	\$11.2	\$ 7.8	-	-	-	
Additional Decrements - Cannibalization	\$ 9.0	\$ 3.0	-	-	-	\$12.0
Plan Decrements - Excluding New Products Beyond RICHLAND	\$16.9	\$21.0	\$17.4	\$17.2	\$8.6	\$81.1
Additional Decrements - Cannibalization	\$ 9.0	\$ 3.0	\$ 2.0	\$ 3.0	\$4.0	\$21.0
Decrements Over Five Year Period Assuming Proposed Strategy	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

As indicated in the table, incremental Plan LIFO Leaf decrements of \$12.0 million would be experienced over the Plan period as a result of the incremental cannibalization and assuming B&W does not enter the economy segment.

If we assume B&W's non-entry and the absence of New Products beyond Richland, the incremental decrements over the Plan period from cannibalization become \$21.0 million.

Entry into the economy segment under the assumptions included in the proposal would avoid Plan period decrements of \$31.0 million (assuming successful New Product introductions) or by as much as \$102.1 million (assuming no New Product introductions beyond Richland).

SUMMARY IMPACT ON FIVE YEAR PLAN DOMESTIC VOLUMES
OF ECONOMY BRAND PROPOSAL
 QUANTITIES IN BILLIONS

	<u>*1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>TOTALS</u> <u>1984-1988</u>
Industry	<u>583.5</u>	<u>596.8</u>	<u>594.9</u>	<u>593.3</u>	<u>590.7</u>	
B&W Five Year Plan						
(Established Brands): Volume	64.7	62.6	59.1	55.7	52.6	294.7
: Share	11.1%	10.5%	9.9%	9.4%	8.9%	
Impact of Cannibalization						
on B&W: Volume	- 2.7	- 5.4	- 6.2	- 7.0	- 7.7	- 29.0
: Share	- .5%	- .9%	- 1.0%	- 1.2%	- 1.3%	
B&W Established Brands						
Post Cannibalization: Volume	62.0	57.2	52.9	48.7	44.9	265.7
: Share	10.6%	9.6%	8.9%	8.2%	7.6%	
<hr/>						
Additional Volume						
- Black & White/Private Labels	2.2	15.2	21.1	22.8	23.8	85.1
Additional Volume						
- Hallmark	<u>.3</u>	<u>1.4</u>	<u>2.3</u>	<u>3.2</u>	<u>3.5</u>	<u>10.7</u>
Revised Established Brand Volume						
After Proposed Entry	64.5	73.8	76.3	74.7	72.2	361.5
Revised Established Brand Share						
After Proposed Entry	11.1%	12.4%	12.8%	12.6%	12.2%	

* 1984 B&W Plan Volumes have been reduced due to lower Industry expectations.

NOTE: The impact of the growth of the economy segment on New Products has not been quantified.

B. E. B.

5/14/84

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TRADING PROFIT OF ECONOMY BRAND PROPOSAL

DOLLARS IN MILLIONS

	<u>*1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>TOTALS</u> <u>1984-1988</u>
B&W Five Year Plan Trading Profit	\$416.1	\$456.8	\$496.0	\$549.7	\$608.9	\$2,527.5
Impact of Economy Brand Cannibalization	<u>- 29.5</u>	<u>- 65.3</u>	<u>- 82.2</u>	<u>-101.0</u>	<u>-120.2</u>	<u>- 398.2</u>
B&W Trading Profit Post Cannibalization	\$386.6	\$391.5	\$413.8	\$448.7	\$488.7	\$2,129.3
<hr/>						
Additional Trading Profit						
- Black & White/Private Label	\$ 5.2	\$ 43.6	\$ 75.6	\$ 98.4	\$119.9	\$ 342.7
Additional Trading Profit						
- Hallmark	<u>(1.3)</u>	<u>.4</u>	<u>5.2</u>	<u>11.2</u>	<u>15.0</u>	<u>30.5</u>
Revised Trading Profit	<u>\$390.5</u>	<u>\$435.5</u>	<u>\$494.6</u>	<u>\$558.3</u>	<u>\$623.6</u>	<u>\$2,502.5</u>
Memo: Plan LIFO Decrement Avoided (Not Included)	\$ 11.2	\$ 7.8				\$ 19.0
Memo: Plan Cannibalization Decrement Avoided (Not Included)	<u>9.0</u>	<u>3.0</u>				<u>12.0</u>
Total Decrement Avoided (Not Included)	\$ 20.2	\$ 10.8				\$ 31.0

* 1984 B&W Plan Trading Profit has been reduced from \$431.5 due to delay in RICHLAND launch and lower Established Brands volume as a result of lower Industry projection.

NOTE: The impact of the growth of the economy segment on New Products has not been quantified.

B. E. B.
5/14/84

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IMPACT ON B&W'S FIVE-YEAR PLAN TRADING PROFIT OF GROWTH
IN BRANDED GENERIC AND BLACK & WHITE/PRIVATE LABEL GENERIC
CONTRIBUTING AT A 2.0X FACTOR AND 1.7X FACTOR
- RESPECTIVELY

(DOLLARS IN MILLIONS/QUANTITIES IN BILLIONS)

	1983 <u>ACTUAL</u>	*1984	1985	1986	1987	1988	TOTAL <u>1984-1988</u>
Industry Estimate		583.5	596.8	594.9	593.3	590.7	
B&W Firm Plan Established Brands							
Share	11.5	11.1	10.5	9.9	9.4	8.9	
Volume	68.2	64.7	62.6	59.1	55.7	52.6	
Generics							
Branded	-	2.3	12.5	14.3	16.6	19.5	
Black & White/Private Label	17.4	28.8	32.2	35.1	38.0	39.6	
Total Volume	17.4	31.1	44.7	49.4	54.6	59.1	
Year-To-Year Volume Change		+13.7	+13.6	+ 4.7	+ 5.2	+ 4.5	
Impact of Cannibalization on B&W @ 2.0X for Branded and 1.7X for Black & White/Private Label							
Volume							
Volume Cannibalized		- 2.7	- 5.4	- 6.2	- 7.0	- 7.7	-29.0
Adjusted Volume		63.7	57.2	52.9	48.7	44.9	
Adjusted Share		10.6	9.6	8.9	8.2	7.6	
Trading Profit Impact							
Variable Margin		\$(38.7)	\$(85.0)	\$(106.2)	\$(130.0)	\$(154.3)	\$(514.2)
Marketing Spend		5.9	12.6	15.3	18.5	21.5	73.8
Manufacturing Overheads		1.4	2.9	3.5	4.1	4.9	16.8
Profit Sharing		1.9	4.2	5.2	6.4	7.7	25.4
Trading Profit		<u>\$(29.5)</u>	<u>\$(65.3)</u>	<u>\$ (82.2)</u>	<u>\$(101.0)</u>	<u>\$(120.2)</u>	<u>\$(398.2)</u>

* 1984 B&W Plan Volumes have been reduced due to lower Industry expectations.

NOTE: The impact of the growth of the economy segment on New Products has not been quantified.

T. W. W.
5/14/84

DISK 91

TRADING PROFIT EFFECT
OF B & W ENTERING GENERIC MARKET
BLACK AND WHITE/PRIVATE LABELS

	1984	1985	1986	1987	1988	TOTAL
VOLUME	2.2*	15.2*	21.1*	22.**	23.**	*5.1*
SALES REVENUE	41,492	3**,96*	441,623	5*4,336	5**,492	1,843,9*3
RATE PER M	1*.86	19.**	2*.93	22.12	23.34	21.67
VARIABLE COST	(31,262)	(221,464)	(314,6*1)	(34*,612)	(373,66*)	(1,289,599)
RATE PER M	14.21	14.57	14.91	15.29	15.7*	15.15
VARIABLE MARGIN	1*,23*	79,496	127,*22	155,724	181,832	5*4,3*4
RATE PER M	4.65	5.23	6.*2	6.83	7.64	6.51
TRADE ALLOWANCES	(3,63*)	(25,***)	(34,*15)	(37,62*)	(39,27*)	(14*,415)
RATE PER M	1.65	1.65	1.65	1.6*	1.65	1.65
BRAND CONTRIBUTION/(LOSS)	6,6**	54,416	*2,2*7	118,1*4	142,562	413,**9
RATE PER M	3.**	3.5*	4.37	5.18	5.99	4.86
INCREMENTAL OVERHEAD	(1,1**)	(*,***)	(11,*16)	(13,452)	(14,994)	(49,418)
RATE PER M	*.5*	*.53	*.56	*.59	*.63	*.58
PROFIT SHARING	(33*)	(2,782)	(4,*23)	(6,279)	(7,6*4)	(21,***)
RESERVE FOR TRADING PROFIT OR ADDITIONAL TRADE ALLOWANCES	(5,17*)	(43,57*)	(75,*6*)	(98,373)	(119,914)	(342,6*3)
RATE PER M	2.35	2.*7	3.5*	4.31	5.**	4.*3
TRADING PROFIT	(*)	(*)	(*)	(*)	(*)	(*)

• Sales Revenue: 1984 – Assumes no additional increase in 1984 from current 5/3/84 prices.

1985 and Forward – Assumes the same net price relationship of Generic to full priced products that exist at present (65% of full priced).

- Variable Cost – Assumes *no* manufacturing cost improvements due to specification changes, etc.
- Trade Allowances – Were assumed to be the same as used in the February proposition.

[* = Illegible]

TRADING PROFIT EFFECT
OF B&W ENTERING GENERIC MARKET
HALLMARK

(Dollars In Thousands)

	1984	1985	1986	1987	1988	TOTALS
Volume (Billions)	.30	1.40	2.30	3.20	3.50	10.70
Sales Revenue	5,589	27,370	47,518	69,888	80,640	231,005
Rate Per M	18.63	19.55	20.66	21.84	23.04	21.59
Variable Cost	(4,263)	(20,398)	(34,293)	(48,928)	(54,950)	(162,832)
Rate per M	14.21	14.57	14.91	15.29	15.70	15.22
Variable Margin	1,326	6,972	13,225	20,960	25,690	68,173
Rate per M	4.42	4.98	5.75	6.55	7.34	6.37
Introductory Allowance	(78)	(122)	-	-	-	(200)
Distribution Allowance	(130)	(677)	(1,193)	(1,652)	(1,805)	(5,457)
Merchandising Support	(2,300)	(5,000)	(5,240)	(5,494)	(5,764)	(23,798)
Rate per M (Total Marketing)	8.36	4.14	2.80	2.23	2.16	2.75
Brand Contribution/(Loss)	(1,182)	1,173	6,792	13,814	18,121	38,718
Rate per M	(3.94)	.84	2.95	4.32	5.18	3.62
Incremental Overhead	(150)	(742)	(1,288)	(1,888)	(2,205)	(6,273)
Rate per M	.50	.53	.56	.59	.63	.59
Profit Sharing	80	(26)	(330)	(716)	(955)	(1,947)
Trading Profit/(Loss)	(1,252)	405	5,174	11,210	14,961	30,498

Selling Prices - will be the same as Generic (Black & White) prices, however, discount terms will be 3¹/₄ rather than 2% allowed on Generic.

Variable Cost - Assumes no manufacturing Cost improvements (same as Black & White)

Introductory Discount Allowance - Assumes \$9.60 per 12M case (.80 per M) on the first month sales.

Distribution Incentive Program

1984	- .48
1985	- .49 weighted
1986-1988	- .51

Merchandising Support - Has been included at \$5,000 in 1985, increased in the forward years for inflation.

B. E. B.
5/12/84

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SUMMARY
IMPACT ON B&W'S FIVE-YEAR PLAN TRADING PROFIT OF GROWTH
IN GENERICS WITH B&W NOT PARTICIPATING AND B&W
CONTRIBUTING AT A 1.0X FACTOR

(DOLLARS IN MILLIONS/QUANTITIES IN BILLIONS)

	1983 <u>ACTUAL</u>	*1984	1985	1986	1987	1988	<u>TOTAL</u> <u>1984-1988</u>
<u>Industry Estimate</u>		583.5	596.8	594.9	593.3	590.7	
<u>B&W Firm Plan Established Brands</u>							
Share	11.5	11.1	10.5	9.9	9.4	8.9	
Volume	68.2	64.7	62.6	59.1	55.7	52.6	
<u>Generics</u>							
Branded	-	2.3	12.5	14.3	16.6	19.5	
Black & White	17.4	28.8	32.2	35.1	38.0	39.6	
Total	17.4	31.1	44.7	49.4	54.6	59.1	
Year-To-Year Volume Change		+13.7	+13.6	+ 4.7	+ 5.2	+ 4.5	
<u>Impact of Cannibalization @ Fair Share</u>							
Volume Cannibalization		- 1.5	- 2.9	- 3.3	- 3.8	- 4.2	-15.7
Adjusted Volume		64.9	59.7	55.8	51.9	48.4	
Adjusted Share		10.8	10.0	9.4	8.7	8.2	
<u>Trading Profit Impact</u>							
Variable Margin		\$(21.5)	\$(45.6)	\$(56.5)	\$(70.6)	\$(84.2)	\$(278.4)
Market Spend		3.3	6.8	8.1	10.0	11.7	39.9
Manufacturing Overheads		.8	1.5	1.8	2.2	2.6	8.9
Profit Sharing		1.0	2.2	2.8	3.5	4.2	13.7
Trading Profit		<u>\$(16.4)</u>	<u>\$(35.1)</u>	<u>\$ (43.8)</u>	<u>\$(54.9)</u>	<u>\$(65.7)</u>	<u>\$(215.9)</u>

* 1984 B&W Plan Volumes have been reduced due to lower Industry expectations.

NOTE: The impact of the growth of the economy segment on New Products has not been quantified.

T. W. W.
5/14/84

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BRAND CONTRIBUTION

(1984 ESTIMATED; 1985-1988 FIVE YEAR PLAN)

(Dollars In Millions)

<u>PLAN</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>TOTAL 1984-1988</u>
Volume (Millions)	6,400	5,946	5,385	4,861	4,386	26,978
Margin	\$ 93.9	\$ 94.2	\$ 92.1	\$ 89.8	\$ 87.5	\$ 457.5
Rate per M	14.67	15.84	17.11	18.48	19.96	
Marketing Spend	11.1	10.9	10.4	9.9	9.4	51.7
Brand Contribution	<u>\$ 82.8</u>	<u>\$ 83.3</u>	<u>\$ 81.7</u>	<u>\$ 79.9</u>	<u>\$ 78.1</u>	<u>\$405.8</u>

IMPACT ON CONTRIBUTION - CONVERTING TO BRANDED GENERIC

	<u>JULY- DEC.</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>TOTAL 1984-1988</u>
Volume (Millions)	3,283	5,946	5,385	4,861	4,386	23,861
Margin Lost	<u>\$-32.4</u>	<u>\$-63.1</u>	<u>\$-61.0</u>	<u>\$-58.1</u>	<u>\$-55.4</u>	<u>\$- 270.0</u>
Volume required to breakeven - approximately 3.0X						
Memo Data:						
<u>Selling Price Differential Per M</u>						
Full Price	\$28.49	\$30.26	\$31.98	\$33.80	\$35.67	
Doral Price	18.63	19.65	20.66	21.84	23.04	
	<u>\$ 9.86</u>	<u>\$10.61</u>	<u>\$11.32</u>	<u>\$11.96</u>	<u>\$12.63</u>	

T. W. W.
5/14/84

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REDACTED

MEMORANDUM

TO: L. W. BUTLER
D. P. CHRISTENSEN
C. C. MIDDLETON
A. E. ROZEK
D. J. BORES
J. K. THARALDSON
G. E. GREENIER

FROM: T. A. OLGES

SUBJECT: *DOMESTIC COMPETITIVE ANALYSIS*

DATE: MAY 15, 1984

Enclosed is your personal copy of the Domestic Competitive Analysis May 1984 Update. The intent of this document is to provide Brown & Williamson management a better understanding of our major competitors' total businesses.

However, care should be exercised in the circulation and safe retention of this "RESTRICTED" document. The Domestic Competitive Analysis Update is for internal use only and no additional unauthorized copies should be made.

If you have any suggestions or comments concerning this document, please feel free to contact me.

/s/ Trina Olges
T. A. Olges

Enclosure

/mjs/2021]

* * *

<u>Brand</u>	<u>Characteristics</u>	<u>Dates</u>	<u>Other</u>
Oasis	Filter, 85mm, menthol flavor only (no regular)	Withdrawn 1983	
Scotch Buy	Filter, 85mm, reg. & Menthol flavor, low tar, soft pack, filter, 100mm, reg. flavor, low tar, soft pack; filter, 85mm, reg. ultra low, soft	Advertised in Washington, DC in Summer 1983	Private label brand for Safeway supermks lights=14 mg. tar, 1.1 mg. nicotine; ultra lights=6 mg. tar, 0.7 mg. nicotine advertised at \$6.99 per carton

3. *Creative*

L&M has run very little advertising in the past several years. Most of their recent growth has come from slightly advertised styles - generics. They continue to run well-targeted fractional page units to support Eve.

4. *Gaps in Brand Portfolio* (Reference Appendixes 5, 6 and 7)

L&M remained strong in the Plains, 120mm and Slims segments based on a slight increase in Eve and continued lack of activity in the Plains segment.

L&M's Light segment share continues to improve through the strong performance of Generic Light Kings, 100s, Menthol Kings and Menthol 100s.

L&M's 1982 portfolio gap in the Ultra Light segment (FSI=17) was substantially filled (FSI=70) with the recent introduction of Generic line extensions - Ultra lights Non-Menthol and Menthol Kings and 100s. With strong generic performance in 1984, L&M is estimated to achieve a relatively balanced portfolio, with remaining gaps in only the full taste and box categories.

L&M's future rests on generics growth, as it is L&M's only large brand, it must generate both growth and funds for L&M.

	Growing		Brand	Declining	
	'83 Share	'83 Growth		'83 Share	'83 Growth
Large: (SOM > 2)	Generic	2.9	None		
Small: (SOM < 2)	Eve	.4	L&M Lark	.7 .4	-11.9% - 5.7

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III. GENERIC COMPETITION

Recent Trends

The dramatic success of Liggett and Myers' generic/private label cigarettes has been a major concern for the cigarette manufacturers. In little more than four years, generic sales have grown to 4% of all Domestic cigarette sales. However, this growth in share has been a recent phenomenon. During the first two years of national introduction, generic cigarettes commanded little attention in the marketplace and reached less than .5%. For 1982, share grew to .9% and in 1983 spurted to 2.9%. For year-end 1984, some analysts estimate the generic share as high as 4.5-5%.

Short-Term Forecast

With the continued growth of generic cigarettes as with many other generic products, their success appears more than a temporary trend. Although the inflationary price structure caused by the Federal Excise tax increase and the U.S. recession fueled the products' quick growth, L&M's actions including introduction of a broad product line, increased distribution, private label manufacture, good wholesaler/retailer margins, long-term contracts and quality products have insured that these products will become a permanent category in the marketplace. L&M's strategies have made generic cigarettes a legitimate alternative, recession or not, for a certain number of smokers. However, the question of the ultimate size of this segment long-term remains. Some analysts view generic growth as peaking in 1984. Others in the industry anticipate continued further generic growth, though at a substantially slower rate, and that the segment will grow potentially becoming 7% or more of the market.

Competitive Activity

Generic growth represents volume erosion for all competitors. Unchallenged, L&M will continue aggressive segment development since it has virtually no stake in the branded, full price market.

1983 Losses to Generics (Total Generic Volume of 17.48 Sticks in 1983)

	Contribution to Generics*	Fair Share Loss Index	Volume Loss (BB Sticks)	Variable Margin Loss** (\$MM)
American Brown & Williamson	7.0	(83)	1.28	16.3
Liggett & Myers	21.1	(170)	3.78	48.2
Lorillard	3.0	(120)***	.58	7.4
Philip Morris	8.0	(83)	1.48	18.9
R. J. Reynolds	22.7	(73)	3.98	50.7
	38.2	(118)	6.78	86.4

*Based on Switching Study, Waves 34 and 35

**Assumes \$12.75/M variable margin

***Excluding generics

While Brown & Williamson had the highest loss relative to fair share, generics had the greatest volume and profit impact on R. J. Reynolds.

By company, we hypothesize the following anticipated competitive actions:

1. *R. J. Reynolds*

In terms of total volume and variable margin lost to generics, RJR is the most vulnerable company now and in the future.

Further, RJR has no brand currently able to replace these lost sales; no established RJR brand grew in 1983. Barring a major new brand success (Sterling or other) or an unforeseen turnaround of an existing brand(s), RJR must assault the economy segment to hold share and volume. In response to generics, RJR will pursue one or more of the following strategies:

Priority One

Launch a generic product line to gain control of and contain generic segment growth. RJR would strive to limit segment development since incremental generic growth will disproportionately reduce RJR's total margins.

During early April 1984, the *Chicago Tribune* reported that RJR was ready to relaunch the Doral brand as a generic and late in April RJR announced Doral as such in a 13-state test market.

Priority Two

Launch a mid-priced brand. This is RJR's second best option to gain volume given its sales force size and strength, domination and control of retail display fixtures and available list of low volume brands. These resources position RJR to distribute and sustain a mid-price at retail.

Priority Three

Increased discounting of RJR's full line of branded products in an attempt to reduce outflows to generics.

Priority Four

Continue and intensify development of the 25's segment.

While RJR may pursue this strategy, the source of business for 25's is currently branded, not generic products. Increased support of 25's does not therefore represent a direct, effective defense against generics' growth.

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LIMITED

MEMORANDUM

May 17, 1984

[Handwritten Note]

Posey Jones
To All
Meetings

TO: R. A. BLOTT

cc: L. W. Butler
D. I. Falk

FROM: [Crossed Out]

SUBJECT: *PROJECT VOLUME - STATUS*

Doug and I have been pushing the "peanut" forward in anticipation of a positive decision. Within reasonable limits, certain department heads have been brought up to speed so that we can respond quickly if London approves Project "V" introduction.

The following is a summary of current "knowns":

Generics

1.) *Tactical Selling Plan*

Attached is a copy of our tactical plan; it will serve two purposes. First, it will be used as the core document for internal operational decisions once you form the implementation task force. Secondly, it contains a revised volume discount structure (page 4) and priority customer "hit list" (page 5).

This document also contains the Heartland Tobacco Company's organizational chart. A full-time exempt staff of seven people is planned. I have recommendations ready for the six selling managers and am working with Jerry Grascch to identify candidates for the Marketing Services position. I want to activate this position as soon as we have a green light.

The final page of this attachment outlines sales territory boundaries fashioned along state lines so that we can compete effectively against current generic volume. No more than two relocations will be necessary. The attached document details are current thinking in regard to clerical support for the six selling managers.

2.) *Packaging*

Doug is in the process of completing finished art. Silk screen or litho labels will be used for the production of initial selling samples.

* * *

5. Negotiated Services

- a. Returned goods - Heartland Tobacco will accept returned goods through B&W from all customers for the purpose of preparing and forwarding affidavits for reimbursement of tax stamps. If a customer insists on credit for returns, five cents will be deducted from his per carton volume discount. (B&W to keep Federal tax reimbursement.)
- b. Retail services beyond initial launch - If these are requested, Heartland Tobacco will provide a quarterly merchandising/inventory control service at a cost to the customer of one cent deducted from his per carton volume discount.
- c. Co-op advertising - No allowance will be provided, but advertising slicks will be made available to customers free of charge.

C. Target Customer List

The following customers will be presented with the initial program offering by the assigned B&W selling managers, as indicated. The Key Accounts Managers currently responsible for these accounts may be called upon to assist as needed.

<u>Customer</u>	<u>Selling Manager</u>
Core-Mark Trade Development A. M. Lewis	L. W. Butler
Generic Products Corp. Bosart Co. Seneco Revco Federated Foods, Inc.*	D. P. Christensen
Fleming Foods	G. A. Greenier
McLane Malone & Hyde	H. E. Higgins
Old Dominion Thomas & Howard	F. J. Schoenheiter
Wetterau	G. A. Korfhage

*Probable supplier for Thomas & Howard (a broker similar to Generic Products Corp.)

The above list represents the 14 largest direct customers with respect to "black and white" generics volume potential (exceptions: Core-Mark and Revco private labels, both of which are primarily "black and white"). B&W will match each customer's current generics label as closely as possible to facilitate consumer acceptance.

[Handwritten Note]

Dick:

Still under debate. We are not prepared to make a firm recommendation yet.

Don C.

(Note: Those customers with retail outlets in the 14-state HALLMARK test area will be offered both HALLMARK and generic brand styles as a "package deal," with cumulative volume for both brands determining the customer's volume discount bracket. See HALLMARK plan for incremental cost of this option.)

D. Retail Point Of Sale

The following fixture/P.O.S. materials will be provided out of each customer's 7¢ per-carton allowance:

1. Permanent displays

- a. Cartons – Separate permanent carton fixtures will be drop-shipped to retail outlets upon receipt of store list from customer.
- b. Packages – Space will be provided on the top shelf of the permanent carton fixture and/or on separate counter displays. Counter displays will be shipped to the customer's warehouse for distribution to retail outlets.

* * *

ATTACHMENT I

POSSIBLE COMPETITIVE REACTIONS AND B&W'S RESPONSES

A. L&M will be forced to address three pressure points applied by B&W's initial offer:

1. *Chain/Distributor Volume/Growth Discount Differential* – L&M currently offers distributors a lower volume and "growth" discount incentive than

they do chains. B&W's offer exceeds L&M's chain offer and is unilateral.

2. *Volume Brackets* – L&M does not offer additional discounts to customers with volumes greater than 500 cases quarterly. B&W's volume discount structure includes two brackets above this volume level.
3. *Advertising Allowance* – L&M currently offers a \$.02-\$.12 per carton allowance for co-op advertising. A probable reaction at some point during the negotiating process will be to drop this allowance and transfer these funds into their volume discount structure.

B. B&W's Reactions

1. If L&M increases its discount offering, B&W will match the increase and raise the offer by an equal amount.
2. If L&M's offer approaches B&W's full variable margin, B&W will withdraw its seven-cent-per-carton fixture/P.O.S. allowance and be prepared to offer a discount structure equal to full variable margin in the highest volume bracket.
3. If L&M reduces list price, B&W will respond with a comparable increase in volume discount structure. (A reduction in list price by L&M is highly unlikely due to the resulting reduction of wholesaler profits in fair-trade states.)
4. If L&M offers returned goods credit at net list, B&W will offer customers a choice of:
 - a) an additional five cent-per-carton discount *or*
 - b) returned goods credit at net list.

5. If L&M increases its sales force support, B&W will offer customers a choice of:
- a) an additional one cent-per-carton discount *or*
 - b) quarterly merchandising/inventory management service.
6. If L&M expands its generics product line to include full-flavor styles, B&W is prepared to match the offer style for style.

/ds644T

COPY TO:
WLS
JAF
"LIMITED"

NOTES ON
PROJECT VOLUME TASK FORCE MEETING,
TUESDAY, MAY 22, 1984

D. Christensen)
D. Falk) Presented
J. Tharaldson)

Project Volume is official. Customer contacts to begin either May 24 or 29.

Heartland Tobacco Co. is the shell company established.

A synopsis of L&M (Gary Tobacco) generic cigarette business follows.

A. *Two offers:*

(1) *Chains*

- List price higher than Dist.
- Volume discount 10-20¢ per carton rebated quarterly based on actual volume.

(2) *Distributors*

- List Lower
- Volume discount 3-15¢ carton

B. *Cooperative Advertising* - 3-12¢ discount per carton set in an escrow account based on performance - i.e. ads demonstrate certain activity level.

C. *Fixture & Display Escrow* - Regardless of volume 7¢ a carton - not on chains.

B&W Program - (Heartland Tob.)

Objective of program is to regain market share and to fill plant capacity - not going into it with the objective to make a profit.

Major thrust is to sell to our 14 top customers.

Four lines of products offered.

- (1) Filter | Largest dist. offered choice of
- (2) Blended | the three - next largest two
- (3) Branded | remaining - next largest - remainder
- (4) Branded Filter - intent to sell to GPC

Three major volume accounts in each state - Control by account/state basis.

No cooperative advertising allowance. Only one offer - one list price - will match L&M's list price.

Terms 2/10, net 14

Volume discounts (proposed)

Quarterly:	> 1,500 cases	30¢ ctn.
	> 1,000 cases	25¢ ctn.
	> 500 cases	20¢ ctn.
	> 200 cases	15¢ ctn.
	> 100 cases	10¢ ctn.
	< 100 cases	List

Up front credit memorandum or check at end of quarter.

Fixtures and displays supplied free - in-house escrow account of 7¢ carton.

B&W will be willing to negotiate the volume discount up to our full variable margin - 85¢ per carton.

Expect initial orders to trickle in due to the fact that it will initially be a process of replacing product already in customers' warehouses - full impact may not be felt until October, 1984.

May 24 - Sales call begin

July 10 - Manufacture begins (may be during shutdown week)

July 24 - First shipment to distributors

After the 14 major customer contacts are made - formalize offer to trade. Offers to trade - negotiated.

Concerns of trade besides price is *service* and quality of product.

B&W fully expects L&M to file suit and to fight price competitively.

CLAUDIA H. KELLEY

05/22/84

/cjs

[Handwritten Note]

Carried by IWH to CIM
in response to BATUS position
that we must show profit

LIMITED

TRADING PROFIT EFFECT OF LAUNCHING BLACK
AND WHITE/PRIVATE LABEL CIGARETTES

In order to displace Liggett & Myers as the trade source of black and white/private label generics, B&W is planning to offer the trade attractive discounts to gain this business.

As indicated on the attached financial schedule, B&W has allowed in the aggregate \$1.65 per M in trade allowances which will vary by customer, depending on the profile of the customer and the volume of business attained.

While B&W does not intend to offer on average more than \$1.65 per M in trade allowances, very large customers may exceed this amount modestly. Therefore, all of the business will yield a favorable trading profit of approximately \$2.35 per M.

Anticipating the L&M will take an aggressive posture in discounting to protect this business, B&W is prepared to counter by increasing trade allowances in the aggregate by an additional \$1.35 per M, which will still leave a trading profit of \$1.00 per M overall and assure this business will be marginally profitable.

Copy given JAL✓
EPT
TWN

PGB

C.J. HEGER/af
5/22/84

TRADING PROFIT EFFECT
OF B & W ENTERING GENERIC MARKET
BLACK AND WHITE/PRIVATE LABELS

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>TOTAL</u>
VOLUME	<u>2.2*</u>	<u>15.2*</u>	<u>21.1*</u>	<u>22.**</u>	<u>23.**</u>	<u>85.1*</u>
SALES REVENUE	41,492	3**,96*	441,623	5*4,336	***,4*2	1,843,9*3
RATE PER M	1*.86	**.**	2*.93	22.12	23.34	21.*7
VARIABLE COST	(31,262)	(221,464)	(314,6*1)	(348,612)	(373,66*)	(1,289,599)
RATE PER M	14.21	14.57	14.91	15.29	15.7*	15.15
VARIABLE MARGIN	1*,23*	7*,496	127,*22	15*,724	181,832	554,3*4
RATE PER M	4.65	5.23	6.*2	6.83	7.*4	6.51
TRADE ALLOWANCES	(3,63*)	(25,***)	(34,*15)	(97,62*)	(39,278)	(14*,415)
RATE PER M	<u>1.65</u>	<u>1.65</u>	<u>1.65</u>	<u>1.65</u>	<u>1.65</u>	<u>1.65</u>
BRAND						
CONTRIBUTION/(LOSS)	*,***	54,416	92,2*7	118,1*4	142,562	413,*89
RATE PER M	*.**	3.58	4.37	5.18	5.99	4.86
INCREMENTAL						
OVERHEAD	(*,***)	(8,*56)	(11,816)	(13,452)	(14,994)	(49,418)
RATE PER M	*.5*	*.53	*.56	*.59	*.*3	*.*8
PROFIT SHARING	(3**)	(2,7**)	(4,*23)	(6,279)	(7,6*4)	(21,*68)
RESERVE FOR TRADING						
PROFIT OR						
ADDITIONAL						
TRADE ALLOWANCES	(5,17*)	(43,57*)	(75,56*)	(9*,373)	(119,914)	(342,6*3)
RATE PER M	2.35	2.*7	3.5*	4.31	5.*4	4.*3
TRADING PROFIT	<u>(*)</u>	<u>—*</u>	<u>(*)</u>	<u>(*)</u>	<u>(*)</u>	<u>(*)</u>

- Sales Revenue: 1984 – Assumes no additional increase in 1984 from current 5/3/84 prices.
1985 and Forward – Assumes the same net price relationship of Generic to full priced products that exist at present (65% of full priced).
- Variable Cost – Assumes *no* manufacturing cost improvements due to specification changes, etc.
- Trade Allowances – Were assumed to be the same as used in the February proposition.

[* = Illegible]

[In Evidence 6/4/84]

HEARTLAND TOBACCO COMPANY

B&W (HEARTLAND)GENERIC CIGARETTES

* * *

DIRECT ACCOUNT INFORMATION -
(FOR FIELD USE ONLY)

First Ship Date: July 17, 1984 (NOTE: Although we will be in a position to make shipments on July 17, we may be under some manufacturing constraints during this first week; therefore, take this into consideration when placing your orders.)

List Price \$18.75 per M - Kings
\$19.75 per M - 100's

Terms:

Introductory 2%, 30 days received; net 31 mailed. Introductory terms will be available on all Heartland products purchased and shipped on or before September 30, 1984.

Regular 2%, 14 days received; net 15 days mailed

CONFIDENTIAL

Trade Allowances:

<u>Quarterly Case Volume Commitment</u>	<u>Per Carton Allowance</u>
1,500 +	30¢
1,000 - 1,499	25¢
500 - 999	20¢
200 - 499	15¢
100 - 199	10¢

Volume rebates will be accumulated on a quarterly basis and a check will be issued from the Home Office based on actual purchases.

We believe Heartland's Trade Incentive offer is a significantly better buy for our customers. Let's compare based on the feedback we're [sic] received from various Field Sales Force personnel.

Competitive Generic
Incentive Plan

<u>Cases Per Qtr.</u>	<u>Per Carton Rebate</u>
100 - 199	0
200 - 249	0
250 - 499	10¢
500 - 999	13¢
1,000 - 1,499	13¢
1,500 +	13¢

Heartland's
Generic Incentive Plan

<u>Cases Per Qtr.</u>	<u>Per Carton Rebate</u>
100 - 199	10¢
200 - 249	15¢
250 - 499	15¢
500 - 999	20¢
1,000 - 1,499	25¢
1,500 +	30¢

- Our Volume Rebate Plan is the same for distributors and direct chains.
- Our Volume Rebate Plan covers cases sold from 100 - 250 cases per quarter. The competitor's incentive program does not.
- We offer additional volume rebates to customers with volume greater than 500 cases per quarter. The competitor's incentive program does not.
- Heartland will pay on the amount of product purchased, not necessarily the contracted amount. For example, if an account contracted for 900 cases at a 20¢ per carton rebate, but actually purchased 1,000 cases, which is at a 25¢ per carton rate, he would receive the 25¢ per carton rebate on the entire 1,000 cases.
- Although the competitor offers a periodic advertising allowance between 2¢ and 12¢ per carton quarterly, keep in mind the customer must pay for the advertising out of this amount. Therefore, the net amount is substantially less. We will provide "ad slicks", free of charge, if the account requests them.
- Customers currently pay shipping and handling for their generic fixtures, or receive them free of charge through special programs and promotions. Heartland will provide fixtures at *no cost*.

In summary, even when all these competitive optional payments are added together, our program is by far more profitable.

Allocation:

Generic cigarettes will not be under allocation.

Refer to Submitting Orders Section for complete details concerning ordering the product.

Returned Goods:

Credits will not be issued to customers for the list price of returned goods. In addition, no handling allowance payment will be made.

Heartland will, however, pay the shipping cost and accept returns for the reimbursement of applicable federal excise taxes and preparing affidavits covering the reimbursement of state and local excise tax.

A special form is being designed for this purpose. In the event you need to return any Heartland Generics before you receive this new form, call Sandee Nielander in the Sales Order Department. Do not combine Generics with regular B&W products on the normal #SA-65.

ADVERTISING AND CONSUMER INCENTIVES

No media advertising is planned at this time. Heartland, however, will provide "ad slicks", free of charge, to accounts if they wish to place advertisements.

Samples of ad slicks will be sent to you in the near future.

No consumer incentive offers are planned at this time.

June 13, 1984

MEMORANDUM

TO: Didi Hunt cc: Don Fish
 Steve Price
 Nancy Rehling
 Marianne Zen[Illegible]

FROM: Cindy Avery

RE: Q SEAL PROGRAM

This forwards a recap of sequential events leading up to development/launch of the Generics Q Seal:

BACKGROUND

Concept of Q Seal initiated by Jim Dowd as potential means of preventing competitive inroads into Generic segment. (Initial correspondence 4/28/82; project tabled by Jim due to price increase opportunity until Fall '83)

Secondary purpose of Q Seal was to reinforce quality among consumers (although it was recognized building awareness of Q Seal Concept would be long term endeavor).

EVENTS

- 1) Development original objectives/strategies for Q Seal program - (December 1982)
- 2) Q Seal Concept Research (February 1983)
 - proposal, summary, final report enclosed

- next steps were to take three viable concepts and refine design/color alternatives
- 3) Seal Alternatives mocked up. Gold Q Seal was recommended because it complimented all Generic/private label packages.

Decision to proceed with Gold Q Seal made by Jim/Agency - 4/12/83, see enclosed project plan

- 4) Agency developed test market plan, enclosed
 - original 2/22/83
 - revised 4/13/83
 - August launch
- 5) Century launch triggered request for evaluation of Q Seal test market v. national introduction, enclosed. Agency recommendation to test market was based on concerns that sales force would not be available for national execution of merchandising/point-of-sale.
- 6) Decision made to go national by Jim; timetable for national launch same as for test market. Artwork for final Q Seal initiated.
- 7) Sell-in of Q Seal Concept initiated June/July '83 with prototypes of Q Seal. First shipment of product with Seal believed to have occurred August/September 1983.
- 8) Sales presentation/correspondence to Mike/Roy, enclosed. Sales meeting - September 1983.

- 9) Q Seal Tracking Study proposal developed/approved 8/27/83.
- 10) Q Seal Media plan developed/approved/targeted for October implementation.
- 11) Advertising Program (Nov. 1983 - Jan. 1983)
- 12) Follow-up
 - Tracking Study implemented/results presented 4/84
 - Q Seal sponsorship of World's Fair
 - Use of Q Seal visual in all advertising/point-of-sale.

We are in the process of developing a proposal which demonstrates how Q Seal can be used to thwart the introduction of generic cigarettes by B & W. We will be in touch to discuss this further.

CA/cg
Enclosures

[Handwritten Notes]

Carol P. Jova

Steve -

Thought you'd find this interesting - result of our sending the B&W lawsuit news release to customers.

I will send him a note thanking him for sharing the info, etc.

Carol

CITY SALES
INC.

WHOLESALE DISTRIBUTORS
Tobacco, Candy, Sundries

524 W. Chicago Avenue,
East Chicago, IN 46321 (219) 397-9040 • (800) [Illegible]

Heartland Tobacco Company
Vice President - Sales
1500 Brown Williamson Tower
Post Office Box 35090
Louisville, Kentucky 40232

June 22, 1984

Sir,

Please accept this as written notification to cancel our "AGREEMENT" and "ORDERS" of Generic cigarettes sold by Heartland Tobacco Co.

After careful consideration we decided not to carry your "brand" of Generics. We feel additional "brands" of

Generic cigarettes added into an established Generic market could lead to the demise of that market.

1. Smokers smoke brands because of "TASTE." Since your blend is different, the smoker will have difficulty identifying the brand he/she can count on supplying them with the "taste" they like, hence, dissatisfaction.
2. Similar packages will lead to the confusion where retailers retain more than one brand of Generic cigarettes.
3. Similar packages will lead to picking confusion and errors by distributors who are almost forced to carry all brands of cigarettes.
4. This "brand" would lead to larger inventories and lower turns of inventory at the distributor level because of competing Generic "brands"
5. Finally, no better deal is being offered as incentive to make a troublesome addition to our inventory. With that we feel there is little hope your "brand" will displace the one we currently use.

Respectfully,

/s/ R. J. Skurka
Robert J. Skurka
Vice President
Sales & Marketing

/s/ Stanley F. Skawinski Jr.
Stanley F. Skawinski Jr.
Vice President
Operations

[Handwritten Note]

Carol,

Thanks for the good news contained in your newsletter dated 2 July '84. You may be interested in our opinion.

Bob Skurka

NEWSNEWSNEWSNEWS
Liggett & Myers Tobacco Company, Inc.,
Durham, N.C.

[Handwritten Note]

Rec'd from Bert Trompeter
 7/6/84

FOR IMMEDIATE RELEASE

CONTACT: CAROL JOVA 919-683-8992 JULY 2, 1984

Liggett & Myers Files Suit Against Brown & Williamson

Today, Liggett Group Inc. filed suit against Brown & Williamson Tobacco Corporation in the Federal District Court in Greensboro, North Carolina. The suit alleges that Brown & Williamson has violated the Federal Unfair Competition Law by simulating Liggett's QUALITY SEAL trademark design which is used to signify the quality of its generic cigarettes. The court papers assert that Brown & Williamson is seeking to capitalize on the goodwill associated with Liggett's QUALITY SEAL trademark which was designed and has been advertised and promoted as a guarantee to consumers that its generic cigarettes are of high quality. Liggett's promotional program for its QUALITY SEAL generic cigarettes includes the sponsorship of a Quality Seal Amphitheater at the New Orleans World's Fair. Liggett has asked the Court to enjoin Brown & Williamson from infringing Liggett's trademark and requests compensatory and punitive damages.

[Handwritten Note]
TO: DPC
FROM: EP

BROWN & WILLIAMSON TOBACCO CORPORATION

A member of the BATUS Group

*1600 West Hill Street
P.O. Box 35090
Louisville, Kentucky 40232*

GLENN M. GRATTA [Illegible] S. YOSEMITE
DEPARTMENT SALES MANAGER SUITE 203
ENGLEWOOD, CO 80112

July 10, 1984

D.P. CHRISTENSEN

Dear Don:

As I have mentioned to you several times in telephone conversations since our entry into the Generic cigarette segment, our customers have been literally deluged with negative comments and publications by Liggett & Meyers [sic] personnel, Gary Tobacco personnel and the General Products Corp. relative to our product, programs and activities. While some of these actions were both expected and one in the spirit of fair competition, much of it is in my opinion not only malicious and unfair, but also based on conjecture.

From the outset our intent has been to recapture the percentage of the business *we* have lost to Generic cigarettes. All of our sales activities and programs have been geared to that end. Our program and any modifications of it have been made available to *all* customers and the provisions have been consistently applied. Our program has been and remains competitive.

The following are examples of occurrences [sic] of competitive activities that I feel to be unfair:

- 1) A mailgram from GPC to customers that alleged our Heartland products to be inferior and composed of low quality tobaccos. This mailgram further charged that our program was not being consistently applied and offered to all customers.
- 2) Numerous reports from my Division Managers that customers have been told by either GPC, Gary Tobacco or L&M personnel that we are trying to "put them out of business" or that we want to "take over the Generic segment" for the purpose of "killing it" or "stopping its growth".
- 3) Comments by a Mr. Al Cagney (either L&M or Gary Tobacco) to Karnett-Venger of Omaha, Nebraska that they (L&M) will match or exceed any and all B&W offers. Mr. Cagney, however, did not put anything in writing to support his comments.
- 4) Numerous reports to my Division Managers that customers were told by L&M personnel that we would be sued and prevented from shipping our product due to the fact that we had "copied" their packaging. These reports came to me over a period of several weeks *prior* to the initiation of *any* litigation against us.
- 5) A report from Division Manager, B. J. Redman - 23E that a Montana customer, F. T. Reynolds had been told by L&M that an *injunction* had been gained against us in North Carolina that would keep us from shipping orders. The customer was told that

"B&W won't be able to ship your order".
The customer replied that he would maintain his agreement and order with B&W and wait and see for himself.

Don, it is one thing to compete on the basis of facts and obvious advantages that your product or program offer. It is an entirely different matter to attempt the same on the basis of conjecture and/or innuendo. Regardless, we continue to compete openly and fairly in the marketplace and represent our product and programs to the customer of our policies. For our part, we will continue to "take the high ground" of honesty and professionalism with our customers. If you have any comments, questions or require further amplifications please let me know.

As always, thanks for your help.

Sincerely,

/s/ Glenn -io.
Glenn M. Gratta

cc: L.W. Butler
H.E. Higgins
Sharon Smith

July 13, 1984

STATUS REPORT: Brown & Williamson Generic Entries

Sales

Brown & Williamson began shipments of its generic line-up on July 9, 1984. Our performance to-date has been encouraging:

- Through July 12, the Company has received initial orders exceeding 150 million sticks. This translates to about 2.8 million units for 1984.
- For 1985, accounts in hand alone should sell approximately 6.6 billion generic units, without any allowance for customers currently pending or private labels.

From an account standpoint, we have signed a number of larger distributors including Trade Development (projected 600 million generic units per year) and Bosart's (projected 375 million generic units per year). In regards to private labels, the Company is still in the process of intensive negotiations, and we expect final decisions with said accounts sometime in the next few weeks. In addition, the military has also begun taking orders for generic product.

* * *

Brown & Williamson continues to believe that the Company's generic program is both lawful and highly competitive. However, primarily to avoid public relations problems that might hinder us from selling and shipping orders for generic products, the Company has elected to aggressively move to have the case withdrawn or dismissed as early as possible. Accordingly, B&W is unilaterally taking steps to effect a number of changes in its package design, which will not hinder our marketing effort, but will answer Liggett's points of contention. It would then

be our intention to try to settle the case with Liggett out-of-court. The package changes include the following:

1. *B&W Closure Seal* - Brown and Williamson is moving to a closure design which includes the words "Superior Tobacco" and incorporates a lion graphic. The closure will continue to be printed in gold and black.

B&W Revised
Closure Seal

Liggett
Closure Seal

[Photocopy of cigarette package seals deleted in printing]

2. *B&W Leaf Design on Package* - Brown & Williamson plans to replace the leaf on this package with a generic design incorporating back-to-back letter B's capped by a crown.

B&W Revised
"Branded" Package

Liggett
"Quality Package"



If B&W is unable to settle the case with the Liggett Group outside of court, we will ask the judge to terminate the case in some fashion. We plan to be in court if necessary within the next 10 - 14 days. One possible ruling might be that the judge would tell us not to use the leaf or the "Q", which we are already moving away from, and at the same time would rule that B&W's new product design is beyond any cavil.

If B&W is unsuccessful in having the case terminated, a normal course of action would see a number of months of discovery leading to a trial which could last up to a year or more.

The Law Department is confident that Liggett & Myers will not succeed in obtaining an injunction or any other court sanction which would constrain our current marketing effort.

* * *

Financials

B&W recently altered its generic offer to our customers. This change was again designed to keep B&W competitive. Brown & Williamson's current generic program pays in total from 55¢ per carton at the lowest volume level to 75¢ per carton at the highest volume level. This translates to a 79¢ per thousand trading profit, as shown in the following exhibit.

* * *

B&WWEIGHTED AVERAGE COSTS/PROFITSGENERIC BUSINESSPer M Cigarettes

	<u>Original Finan- cial</u>	<u>Round 2</u>	<u>Round 3</u>	<u>Round 4</u>	<u>1985</u>
Trading Profit					
Pre Rebates	4.00	4.04	4.07	4.30	4.26
Less:					
Fixtures @					
\$.07/					
carton (1)	.35	.35	.35	.35	.20
Volume					
Rebate (2)	1.30	1.68	1.54	2.22	2.22
Prompt					
Contract					
Rebate (3)	--	.47	.47	.47	A .24
Promotional					
Allowance					
(4)	--	--	.47	.47	.24
Sub-total	<u>1.65</u>	<u>2.50</u>	<u>2.83</u>	<u>3.51</u>	<u>2.90</u>
1984					
TRADING					
PROFIT	<u>2.35</u>	<u>1.54</u>	<u>1.24</u>	<u>.79</u>	<u>1.36</u>

(1) To 6/30/85

(2) To 6/30/85

(3) To 6/30/85

(4) To 6/30/85

A - B&W composite offer \$3.16.

L&M 7/9/84 offer assuming B&W mix \$2.86.

July 10, 1984

[Illegible]
7/11/84NEWSNEWSNEWSLIGGETT & MYERS TOBACCO COMPANY, INC.,
Durham, N.C.

FOR IMMEDIATE RELEASE

JULY 18, 1984

CONTACT: CAROL JOVA 919-683-8992

Liggett Group Inc. announced today that it has filed an amended complaint in Federal District Court in Durham, North Carolina against Brown & Williamson Tobacco Corporation seeking damages for alleged violations of the antitrust laws in the cigarette market and injunctive relief to bar such practices.

Liggett, the smallest major U. S. manufacturer, accounted for less than 5% of total domestic 1983 cigarette sales. More than half of Liggett's sales were in the generic segment of the cigarette market. B&W, the nation's third largest cigarette manufacturer, accounted for approximately 11% of domestic cigarette sales, all of which were of branded cigarettes where margins are substantially higher.

The amended complaint alleges that B&W, which has recently announced it is entering the generic segment, is engaged in unlawful predatory pricing designed to eliminate Liggett as a competitor in the marketplace.

FIELD SALES NOTICE

URGENT

B&W

TO: ALL FIELD MANAGERS EXCEPT SPECIAL
MARKETS

GENERIC/PRIVATE LABEL
PRODUCT INFORMATION

As promised in previous communication, we plan to remain competitive in the Generic/Private Label business. Consequently, we are pleased to announce two additional competitive revisions to our Generic/Private Label Offer.

1) New Volume Rebate Offer

Effective immediately, we have a new per carton offer as shown below.

QUAR- TERLY CASE VOLUME	PER CARTON ALLOWANCES			
	REBATE	BONUS REBATE	PROMO ALLOW- ANCE	TOTAL
0-400	40¢	\$.10	\$.10	60¢
500-999	45¢	\$.10	\$.10	65¢
1000-1499	50¢	\$.10	\$.10	70¢
1500-7999	55¢	\$.10	\$.10	75¢
8000+	60¢	\$.10	\$.10	80¢

The above offer (including bonus rebate and promotional allowance) is good through June 30, 1985.

All customers from whom we've received orders/agreements will automatically receive this new rebate allowance.

#DS-2494
07/19/84

LIMITEDMEMORANDUM

TO: Mr. C. J. Heger
FROM: Mr. A. C. Diebold

DATE: July 26, 1984

SUBJECT: *Liggett Strategy In Regard To Generics*

I have made a very rough cut at this question as sufficient time was not available. My first step was to determine the estimated Variable Cost and Margin for Liggett's Generics and the associated Manufacturing Overheads. I used B&W's cost as a basis and adjusted them as follows:

- A. *Leaf Cost* - B&W's current cost is estimated at \$3.75 per M. I have always felt that Liggett probably has a cheaper Leaf Blend (possible increased usage of off-shore from their Brazilian subsidiary); therefore, I cut B&W's cost by 5%.
- B. *Labor Cost* - B&W's Labor Cost based on Macon's manning is \$.46 per M. This is probably considerably lower than Liggett's Durham Plant. However, to be conservative I increased this cost by only 10%.
- C. *Other Variable Cost* - Casing, Wrapping, Filter, Freight and Excise Tax was assumed to be the same as B&W's.

The results of the above calculation produce a margin for Liggett's Generics before rebates, etc. of \$4.77 per M. This compares to \$4.65 per M for the B&W products.

In regard to overheads, our previous study (Liggett acquisition) indicated Durham's overheads amounted to \$40.8 million for a volume of 39 billion. Since we are still

in the same volume range we used this same figure. On a full allocated basis this would work out to \$1.09 per M. The \$40.8 million estimated was based on an incremental overhead cost (incremental to established branded products of \$.50 per M).

The volume assumptions are critical to anticipating Liggett's strategy. I discussed this with Hal Hughes who had the following thoughts:

Mr. Hughes believes the Generic market is still growing and with B&W having entered the markets, and other potential entrants into the market (it is rumored that Lorillard is about to enter), Hal believes the market will continue to grow over the foreseeable future. He estimates a total Generic volume of around 30 billion for 1984, possibly more. Hal feels current B&W projections are a bit high and anticipates a B&W volume

* * *

As can be seen the operating income for Generics is only \$9 million. This reduces the total operating income to around \$42 million as opposed to the previous fiscal year of \$51 million.

We are also showing on Schedule II the likely reduction in Interest Income which should result as the working capital requirement to sustain the incremental volume increases. The figure was based on variable cost including the duration factor for leaf and a 13% interest rate was computed. After taking this cost into account, the Generic volume is producing a pre-tax loss of \$18 million.

Summary

Turning to the direct question asked i.e. - What will Liggett do and how long can they hold on? My thoughts are as follows:

First we already know that Grand Met is attempting to dispose of the tobacco business. The entry of B&W into the business has driven down the potential price for the business and has spoiled the financing for the leveraged buyout. While the Liggett Group is no doubt mad as hell, and may desire to do anything to stop B&W, from Grand Met's viewpoint they need to find a buyer and protect the potential selling price as much as possible. I would doubt that they would allow Liggett to continue to meet and beat our cigarette selling prices and will probably attempt to raise prices as soon as possible. In short I believe that they have or will shortly decide to share the market with B&W and others. In the meantime they will probably continue to search for a buyer. I fear that if B&W does not purchase Liggett, they could be sold to someone such as U. S. T. of Culbro.

As to Liggett's staying power, if B&W continues to cut prices, they will be forced in the short term to meet our prices, but not to beat them. They would count on B&W increasing price around the first of the year or sooner. If they can't find a buyer at any price, their long term strategy would be to milk the entire business.

If I can be of further help, please let me know.

A. C. D.

/af

[In Evidence August 17, 1984]

GENERIC CIGARETTE PRICING SUMMARY
(EXHIBIT I)

L&M (June 4, 1984)

(1) CASES/ (QTR)	(2) LIST (CTN)	(3) BONUS/ DIS./ALLOW		(4) REBATES		(5) RETAIL PROMO.	(6) NET COST	
		GPC	FRAN	ADV.	CTN. PUR.		GPC	FRAN
0-99	\$3.75	\$ 0	\$ 0	\$0	\$0	\$.077	\$3.673	\$3.673
100-199	3.75	0	0	.09	0	.077	3.583	\$3.583
200-499	3.75	0	.10	.09	0	.077	3.583	3.483
500-999	3.75	0	.13	.09	0	.077	3.583	3.453
1,000-1,499	3.75	0	.13	.09	0	.077	3.583	3.453
1,500+	3.75	0	.13	.09	0	.077	3.583	3.453

B&W (June 4, 1984)

0-99	\$3.75	-	\$ 0	-	\$3.75
100-199	3.75	-	.10	-	3.65
200-499	3.75	-	.15	-	3.60
500-999	3.75	-	.20	-	3.55
1,000-1,499	3.75	-	.25	-	3.50
1,500+	3.75	-	.30	-	3.45

(1) Bracket structure by volume of cases sold per quarter.

(2) List price per carton.

(3) Bonus, discount and allowance monies. L&M column segmented for GPC (combination) and franchise.
NOTE: B&W's column is not segmented.

(4) Rebate monies are segmented for L&M into advertising and carton purchase.

L&M (ADV.) - \$.09 based on maximum rate of \$.12 annualized. It is offered only 3 quarters/year. ($$.75 \times $.12 = $.09$)

B&W - rebate schedule established for all customers based on volume.

(5) Retail promotion (L&M) - Because of the 14 state Doral areas, L&M responded with a 13-week dollar off retail price stickers. One week's purchases qualified for these stickers. ($\$1.00 - 13 \text{ weeks} = \$.077$)

(6) Net cost reflects annualization of all discounts, allowances, bonuses, rebates and promotional offers at maximum rate *plus* 100% participation.

/tm/1570B/1

GENERIC CIGARETTE PRICING SUMMARY
(EXHIBIT II)

L&M (6/18 Eff. 8/1)

(1) CASES/ (QTR)	(2) LIST (CTN)	(3) BONUS/ DIS./ALLOW		(4) REBATES CTN.		(5) RETAIL PROMO.	(6) NET COST	
		GPC	FRAN	ADV.	PUR.		GPC	FRAN
0-99	\$3.75	\$.045	\$.005	\$ 0	\$.10	\$.077	\$3.528	\$3.568
100-499	3.75	.045	.105	.09	.15	.077	3.388	3.328
500-999	3.75	.040	.135	.09	.20	.077	3.338	3.248
1,000-1,499	3.75	.045	.135	.09	.25	.077	3.288	3.198
1,500+	3.75	.045	.135	.09	.30	.077	3.238	3.148

B&W (June 21, 1984)

0-99	\$3.75	\$.10	\$.10	—	\$3.55
100-199	3.75	.10	.20	—	3.45
200-499	3.75	.10	.25	—	3.40
500-999	3.75	.10	.30	—	3.35
1,000-1,499	3.75	.10	.35	—	3.30
1,500+	3.75	.10	.40	—	3.25

- (1) Bracket structure by volume.
- (2) Per carton list remains the same.
- (3) L&M (GPC) – Weighted average which includes 5¢ special full flavor sell-in rebate plus 4¢ GPC allowance. $(\$.04 \times 90\% \text{ volume}) + (\$.09 \times 10\% \text{ volume}) = .045$.
 L&M (FRAN) – Includes full flavor rebate (5¢) plus franchise allowance of 0-13¢. Weighted average based on full flavor rebate at 10% volume as in GPC calculation. $(.18 \text{ allow} + \text{full flavor} \times 10\%) + (.13 \text{ allow} \times 90\%) = .135$.
 B&W – Introduced 10¢ bonus rebate.
- (4) L&M (ADV.) – Maximum rate of 12¢ annualized $(.75 \times .12 = .09)$ remains the same.
 L&M (CTN. PUR.) – Carton purchase rebates began.
 B&W – Rebates increases 10¢.
 L&M – 13-week dollar off promotion remains the same.
- (6) Reflects annualization of all offers at maximum rate plus 100% participation.

GENERIC CIGARETTE PRICING SUMMARY
(EXHIBIT III)

L&M (Week of June 21)

(1) CASES/ (QTR)	(2) LIST (CTN)	(3) BONUS/ DIS./ALLOW		(4) REBATES CTN.		(5) RETAIL PROMO.	(6) NET COST	
		GPC	FRAN	ADV.	PUR.		GPC	FRAN
0-99	\$3.75	\$0.055	\$0.005	\$0	\$0.10	\$0.077	\$3.518	\$3.568
100-499	3.75	.055	.105	.09	.15	.077	3.378	3.328
500-999	3.75	.055	.135	.09	.20	.077	3.328	3.248
1,000-1,499	3.75	.055	.135	.09	.25	.077	3.278	3.198
1,500+	3.75	.055	.135	.09	.30	.077	3.228	3.148

B&W (Week of June 9)

0-99	\$3.75	\$0.10	\$0.10	\$0.10	\$3.45
100-199	3.75	.10	.20	.10	3.35
200-499	3.75	.10	.25	.10	3.30
500-999	3.75	.10	.30	.10	3.25
1,000-1,499	3.75	.10	.35	.10	3.20
1,500+	3.75	.10	.40	.10	3.15

- (1) Bracket structure by volume.
- (2) List price per carton.
- (3) L&M (GPC) – Allowance increases from 4¢ to 5¢. $(\$0.05 \text{ allow} \times 90\%) + (\$0.10 \text{ allow} + \text{full flavor} \times 10\%) = \0.055
 L&M (FRAN) – 0-13¢ allowance plus 5¢ full flavor weighted average remains the same.
 B&W – 10¢ bonus rebate remains the same.
- (4) L&M (ADV.) – No change; Annualized at maximum rate.
 L&M (CTN. PUR.) – Same schedule as Exhibit II.
 B&W – Same schedule as Exhibit II.
- (5) L&M – 13-week dollar off stickers are the same.
 B&W – Introduced 10¢ promotion reserve.
- (6) Reflects annualization of all offers at maximum rate and 100% participation.

[In Evidence August 17, 1984]
 GENERIC CIGARETTE PRICING SUMMARY
 (EXHIBIT IV)

L&M (July 5)

(1) CASES/ (QTR)	(2) LIST (CTN)	(3) BONUS/ DIS./ALLOW		(4) REBATES CTN.		(5) RETAIL PROMO.	(6) NET COST	
		GPC	FRAN	ADV.	PUR.		GPC	FRAN
0-99	\$3.75	\$.127	\$.005	\$ 0	\$.20	\$.154	\$3.269	\$3.391
100-199	3.75	.127	.005	.09	.25	.154	3.129	3.251
200-499	3.75	.127	.105	.09	.25	.154	3.129	3.151
500-999	3.75	.127	.135	.09	.30	.154	3.079	3.071
1,000-1,499	3.75	.127	.135	.09	.35	.154	3.029	3.021
1,500+	3.75	.127	.135	.09	.40	.154	2.979	2.971

B&W (July 9)

0-499	\$3.75	\$.10	\$.35	\$.10	\$3.20
500-999	3.75	.10	.40	.10	3.15
1,000-1,499	3.75	.10	.45	.10	3.10
1,500-7,999	3.75	.10	.50	.10	3.05
8,000+	3.75	.10	.55	.10	3.00

- (1) B&W bracket structure changes.
- (2) List price per carton.
- (3) L&M (GPC) – Allowance increases from 5¢ to 12.2¢. Also includes 5¢ full flavor based on 10% of volume. $(.172 \times 10\%) + (.122 \times 90\%) = .127$.
 L&M (FRAN) – Weighted average of 5¢ full flavor at 10% volume and 0-13¢ allowance.
 B&W – 10¢ bonus rebate.
- (4) L&M (ADV.) – 12¢ maximum rate annualized (3 quarters).
 L&M (CTN. PUR.) – Carton purchase offer increases 10¢.
 B&W – Rebate increase an additional 10¢ all are indication of the new bracket structure.
- (5) L&M – Doral response areas 13-week dollar off sticker offers revised July 18. Two-weeks stock now qualified. $(2 - 13 = .154)$
 B&W – 10¢ promotion reserve.
- (6) Reflects annualization of all offers at maximum rate and 100% participation.

GENERIC CIGARETTE PRICING SUMMARY
(EXHIBIT V)

L&M (July 17)

(1)	(2)	(3)		(4)		(5)	(6)	
CASES/ (QTR)	LIST (CTN)	BONUS/ DIS./ALLOW		REBATES CTN.		RETAIL	NET COST	
		GPC	FRAN	ADV.	PUR.	PROMO.	GPC	FRAN
0-499	\$3.75	\$.127	\$.105	\$ 0	\$.35	\$.154	\$3.029	\$3.051
500-999	3.75	.127	.135	.09	.40	.154	2.979	2.971
1,000-1,499	3.75	.127	.135	.09	.45	.154	2.929	2.921
1,500-7,999	3.75	.127	.135	.09	.50	.154	2.879	2.871
8,000+	3.75	.127	.135	.09	.55	.154	2.829	2.821

B&W (July 18)

0-499	\$3.75	\$.10	\$.40	\$.10	\$3.15
500-999	3.75	.10	.45	.10	3.10
1,000-1,499	3.75	.10	.50	.10	3.05
1,500-7,999	3.75	.10	.55	.10	3.00
8,000+	3.75	.10	.60	.10	2.95

- (1) L&M restructures brackets to that of B&W.
- (2) List price per carton.
- (3) L&M (GPC) – 12.2¢ allowance plus 5¢ full flavor sell-in weighted average.
L&M (FRAN) – 0-13¢ allowance plus 5¢ full flavor sell-in weighted average.
B&W – 10¢ bonus rebate.
- (4) L&M (ADV.) – 12¢ maximum rate annualized (3 quarters).
L&M (CTN. PUR.) – Offer increases 10¢.
B&W – Bonus rebate increases an additional 5¢.
- (5) L&M – Doral 14 state, 13-week dollar off stickers for 2-week purchase qualifiers.
B&W – Promotion reserve.
- (6) Reflects annualization of all offers at maximum rate and 100% participation.

CURRENT
GENERIC CIGARETTE PRICING SUMMARY
(EXHIBIT VI)

L&M (August 16)

(1) CASES/ (QTR)	(2) LIST (CTN)	(3) BONUS/ DIS./ALLOW		(4) REBATES CTN.		(5) RETAIL PROMO.	(6) NET COST	
		GPC	FRAN	ADV.	PUR.		GPC	FRAN
0-499	\$3.75	\$.127	\$.105	\$ 0	\$.40	\$.105	\$3.118	\$3.14
500-999	3.75	.127	.135	0	.45	.105	3.068	3.06
1,000-1,499	3.75	.127	.135	0	.50	.105	3.018	3.01
1,500-7,999	3.75	.127	.135	0	.55	.105	2.968	2.96
8,000+	3.75	.127	.135	0	.60	.105	2.918	2.91

B&W (August 16)

0-499	\$3.75	\$.10	\$.40	\$.177	\$3.073
500-999	3.75	.10	.45	.177	3.023
1,000-1,499	3.75	.10	.50	.177	2.973
1,500-7,999	3.75	.10	.55	.177	2.923
8,000+	3.75	.10	.60	.177	2.873

- (1) Bracket structure bases on cases sold per quarter.
- (2) Carton list price.
- (3) L&M (GPC) – 12.2¢ allowance plus 5¢ full flavor sell-in weighted average.
L&M (FRAN) – 0-13¢ allowance plus 5¢ full flavor sell-in weighted average.
B&W – 10¢ bonus rebate.
- (4) L&M (ADV.) – No longer available.
L&M (CTN. PUR.) – Offer increases an additional 5¢.
B&W – Bonus rebate.
- (5) L&M – Dollar off stickers (2-week duration) for a period of 19 weeks. (2 – 19 = .015)
B&W – Announced dollar off stickers for 1-week duration for a period of 13 weeks (1 – 13 = 0.77) plus 10¢ promotion reserve.
- (6) Reflects annualization of all offers at maximum rate and 100% participation.

/tm/1570B/6

[1984]

NATIONAL MANAGEMENT CONFERENCE

GENERIC/PRIVATE LABEL PRESENTATION

SLIDE 1 (TITLE SLIDE)

THANK YOU DAVE. WHILE THE PAST SIX MONTHS HAVE BEEN FILLED WITH CHALLENGES AND OPPORTUNITIES FOR ALL OF US, ANOTHER CHALLENGE AND OPPORTUNITY HAS BEEN ADDED TO MY PERSONAL AGENDA, AND THAT IS THIS YEAR HAVING TO DIRECTLY FOLLOW DON FISH - THE MASTER OF THE SOUTHERN VOCABULARY AND PRESENTATIONS. DON, OLD PARTNER, YOU'RE A TOUGH ACT TO FOLLOW. BUT I AM HAPPY TO BE HERE AND TAKE THIS OPPORTUNITY TO SHARE OUR PROGRESS AND PLANS IN OUR GENERIC/PRIVATE LABEL AREA.

SLIDE 2

AS ALL OF YOU ARE AWARE, WE'VE BEEN VERY SUCCESSFUL IN OUR GENERIC/PRIVATE LABEL PROPOSITION. WITH THIS KIND OF SUCCESS, IN ANY KIND OF INDUSTRY, NORMALLY COMES THE CHALLENGE OF COMPETITION. AS YOU ARE AWARE, WE HAVE BEEN CHALLENGED IN 1984 AND FEEL THAT WE HAVE NOT ONLY MET THIS CHALLENGE BUT ALSO ARE PREPARED TO MEET IT IN 1985 AND BEYOND.

SLIDE 3

I WOULD LIKE TO SPEND SOME TIME THIS MORNING DISCUSSING THIS CHALLENGE AND HOW IT RELATES TO OUR EVER CHANGING ENVIRONMENT, HOW IT RELATED TO OUR '84 PROGRAMS AND HOW WE'RE PREPARED TO MEET THIS CHALLENGE IN 1985 AND BEYOND.

SLIDE 4

HOW AND WHY DID THE CHALLENGE OF SUCCESS DEVELOP? 1981 THROUGH 1984 WAS A PERIOD OF UNPRECEDENTED GROWTH FOR US IN THE GENERIC/PRIVATE LABEL AREA. IN 1982, WE GREW AT THE RATE OF 160% OVER 1981; 1983 AT A RATE OF 170% AND OUR PLAN GOING INTO 1984 WAS TO GROW AT 64% AGAIN. THIS GROWTH, AGAIN, WAS UNPRECEDENTED IN THE CIGARETTE INDUSTRY. WE ALSO ESTABLISHED SOMETHING THAT WAS AGAIN VERY UNIQUE TO OUR INDUSTRY AND THAT WAS A VERY HIGH LEVEL OF TRADE PARTICIPATION IN A PROGRAM. FOR THE FIRST TIME IN OUR INDUSTRY, WE DEVELOPED A VERY UNIQUE PARTNERSHIP WITH THE TRADE. THEY ACTUALLY HAD A SENSE OF "OWNERSHIP" OF THE GENERIC/PRIVATE LABEL PROPOSITION AND GREW TO TOTALLY SUPPORT OUR PROGRAM TOGETHER WITH THEIR EFFORTS. PRIOR TO THIS PERIOD, NO ONE IN THIS INDUSTRY REALLY BELIEVED THAT THE TRADE COULD BECOME SUCH AN INTEGRAL PART OF A NATIONAL PROGRAM. GENERIC CIGARETTES HAVE GROWN FROM A BASE OF "0" TO NOW BEING SOLD BY MORE THAN 95% OF THE NATION'S SUPERMARKETS AND 90% OF ITS WHOLESALERS. ANOTHER IMPORTANT ELEMENT OF OUR SUCCESS WAS THE EXTREMELY HIGH CONSUMER ACCEPTANCE THAT WE RECEIVED. TODAY'S CONSUMER WAS READY FOR A QUALITY PRODUCT AT A FAIR PRICE. THIS WAS TRULY NOT ONLY A REFLECTION OF ECONOMIC CONDITIONS, BUT AS DON MENTIONED EARLIER, A REFLECTION OF CHANGING CONSUMER VALUES. THERE ALSO HAD TO BE A LOT OF NON-BELIEVERS IN OUR INDUSTRY SINCE UP AND THROUGH MID 1984 WE WERE FORTUNATE NOT TO HAVE ANY COMPETITION IN A CATEGORY THAT WAS GROWING SO FAST. LIGGETT WAS THE CATEGORY AND AS THE CATEGORY GREW, IT BECAME MORE AND MORE ATTRACTIVE FOR COMPETITION TO COME IN AS IT DID IN 1984. THE PROGRAM THAT WE ESTABLISHED WAS ONE THAT WAS CONSIDERED VERY SOPHISTICATED FOR THE CIGARETTE INDUSTRY BUT VERY NECESSARY IN CARRYING A

NON-TRADITIONAL APPROACH TO A VERY TRADITIONAL INDUSTRY. THIS "OWNERSHIP" OR PARTNERSHIP WITH THE TRADE THAT WE TALKED ABOUT EARLIER WAS ESTABLISHED THROUGH A PROGRAM OF BROKERS, FRANCHISE DISTRIBUTORS AND PRIVATE LABEL CUSTOMERS. WE FEEL IT'S VERY IMPORTANT THAT THE PRINCIPLES OF OUR GENERIC/PRIVATE LABEL PROGRAM THAT WE HAVE ESTABLISHED STAY A MAJOR PIECE OF THE FOUNDATION OF OUR BUSINESS AS WE LOOK TO GROW IN THE FUTURE.

SLIDE 5

WE'VE SPENT A LOT OF TIME RECENTLY TALKING ABOUT OUR ENVIRONMENT AND HOW THE ENVIRONMENT CONTINUALLY HAS CHANGED. THE EFFECTS OF THIS ENVIRONMENTAL CHANGE CAN BE IDENTIFIED IN FOUR MAJOR AREAS IN THE GENERIC/PRIVATE LABEL PROGRAM. THESE ARE: COMPETITION, THE TRADE, OUR CONSUMER AND OUR ORGANIZATION. LET'S SPEND SOME TIME NOW TALKING ABOUT THE CHANGE IN THESE FOUR ELEMENTS.

SLIDE 6

COMPETITION IN OUR CATEGORY WAS THE MAJOR CHANGE THAT WE'VE HAD TO DEAL WITH IN 1984. IT'S IMPORTANT THAT WE ALL UNDERSTAND HOW WE FEEL OUR COMPETITION POSITIONED THEMSELVES COMING IN AND WHERE WE FEEL THEY ARE POSITIONING THEMSELVES FOR THE FUTURE. R. J. REYNOLDS WAS THE FIRST MAJOR COMPETITOR TO ENTER THE GENERIC ARENA WITH THEIR DORAL BRAND WHICH WAS POSITIONED AS A BRANDED PRODUCT AT A GENERIC PRICE. THEY FELT THAT THEY COULD PUT NEW ZEST IN A PREVIOUSLY UNSUCCESSFUL BRAND FOR THEM. IT WAS INTRODUCED IN FOUR STYLES: FILTER LIGHTS, FILTER LIGHT 100's, LIGHT MENTHOL KING AND LIGHT MENTHOL 100's. R. J. REYNOLDS HAD DONE THEIR HOMEWORK. WHEN THEY INTRODUCED IT IN MAY OF

1984, THEY WENT INTO 14 STATES - 14 STATES THAT REPRESENTED 44% OF OUR GENERIC/PRIVATE LABEL BUSINESS. BASED ON THE GROWTH THAT THE CATEGORY CONTINUED TO HAVE DURING THIS PERIOD, THEY DECIDED TO EXPAND THE BRAND NATIONAL IN JULY OF THIS YEAR. THEIR STRATEGY WAS TO USE THEIR LARGE RESOURCES, THAT IS, THEIR CLOUT, MONEY AND PEOPLE TO ENTER THIS GROWING CATEGORY. THEY ENTERED THE CATEGORY WITH DIRECT ACCOUNT INCENTIVES OF UP TO 30¢ A CARTON, FREE DISPLAYS FOR THE TRADE, DISPLAY PAYMENTS FOR THE TRADE AND A NATIONAL ADVERTISING PROGRAM. ALL OF THESE ELEMENTS WERE TRADITIONAL BRANDED MARKETING APPROACHES TO A NEW NON-TRADITIONAL CATEGORY.

SLIDE 7

AS A COMPANY, WE VIEWED R. J. REYNOLDS' ENTRY INTO THE GENERIC CATEGORY A LITTLE DIFFERENTLY THAN WE HAD VIEWED COMPETITION IN THE PAST. WE WERE THE BIG GUYS ON THE BLOCK. WE WERE THE EXPERT IN THE CATEGORY AND, MOST IMPORTANTLY, FELT A NEW ENTRY INTO THIS CATEGORY COULD DRIVE THE TOTAL CATEGORY UP. WE ASSUMED AN OFFENSIVE POSTURE. THAT WAS, ONE OF DRIVING THE TOTAL CATEGORY UP. YES, DORAL COULD GET A PIECE OF THE CATEGORY, BUT WE WOULD ALSO GROW AS THE CATEGORY GREW. WE WENT INTO THE 14 STATE AREA THAT R. J. REYNOLDS HAD GONE INTO WITH A VERY AGGRESSIVE PROGRAM THAT INCLUDED DIRECT ACCOUNT VOLUME INCENTIVES, RETAIL INVENTORY BUILD ALLOWANCES, FREE MERCHANDISING FIXTURES, CONSUMER PROMOTION THAT INCLUDED DOLLAR OFF STICKERING, 2 PACKS FREE WITH A CARTON AND BUY 4 GET 1 FREE, AND WE INCREASED OUR COVERAGE. WE BROUGHT IN CREWS OF PEOPLE AT BOTH THE RETAIL AND HEADQUARTER LEVEL. A TEAM EFFORT BETWEEN LIGGETT & GARY SALES PERSONNEL IS WHAT WAS NEEDED FOR THIS, AND A TEAM EFFORT WE RECEIVED. THE EFFORTS OF THE

FINEST SALES ORGANIZATION IN THE INDUSTRY RESULTED NOT ONLY IN INCREASE IN BUSINESS IN THE 14 STATE AREA BUT OVERALL A 25% INCREASE NATIONALLY IN JUNE FOR US. ALSO, OVER 5900 PMD'S WERE PLACED BY OUR ORGANIZATION DURING MAY AND JUNE IN THE 14 STATE DORAL TEST AREA. BUT R. J. REYNOLDS IS A FORMIDABLE COMPETITOR, AND THEY ARE NOT GOING TO GO AWAY, AND EVEN THOUGH THEIR INITIAL MOVEMENT OR CONSUMER PULL WASN'T WHAT THEY PROBABLY EXPECTED, WE FEEL THAT THEY ARE GOING TO BE THERE AT RETAIL. THE DAY TO DAY, STORE TO STORE BATTLE FOR DISTRIBUTION AND MERCHANDISING SPACE IS GOING TO BE ONE THAT WILL BE WON AT RETAIL.

SLIDE 8

BROWN & WILLIAMSON WAS THE NEXT MAJOR COMPETITOR TO ENTER THE GENERIC CATEGORY. THEY FELT THAT THEY COULD USE THEIR CLOUT, MONEY AND PEOPLE, TO REALLY STRIKE AT THE HEART OF OUR BUSINESS AND THAT IS THE BLACK AND WHITE GENERIC PRICED PRODUCT. THEY FELT THEY COULD RIDE OUR COATTAILS OF SUCCESS BY INTRODUCING A PRODUCT AND A PROGRAM THAT HIGHLY RESEMBLED OURS. THEY CAME WITH ALL 8 STYLES IN JULY ON A NATIONAL BASIS. THE MAJOR DIFFERENCE IN THEIR PROGRAM WAS IS [SIC] THAT THEY OWN THEIR BRAND AND SELL IT TO THE ACCOUNTS VERSUS OUR PROGRAM WHERE WE CONTRACTED FOR THE BRAND TO CREATE ACCOUNT OWNERSHIP. THEIR PROGRAM WAS NOT ONLY VERY AGGRESSIVE BUT VERY EXPENSIVE TO THEM AND US. THEY OFFERED DIRECT ACCOUNT INCENTIVES THAT EVENTUALLY ESCALATED UP TO 80¢ A CARTON, FREE DISPLAYS, RETAIL INCENTIVES AND CONSUMER PROMOTIONS.

SLIDE 9

OUR POSTURE WITH BROWN & WILLIAMSON WAS DIFFERENT THAN IT WAS WITH R. J. REYNOLDS. WE FELT WE REALLY HAD TO TAKE A

DEFENSIVE POSTURE. SIMILARITY OF PACKAGING AND THE DIFFERENCE IN TASTE OF THE BROWN & WILLIAMSON PRODUCT TO OUR PRODUCT WE FELT COULD REALLY HURT THE GENERIC CATEGORY, AND THAT IS BOTH FOR THE CONSUMER AND THE RETAILER. OUR PLAN WAS TO PROTECT BOTH THE CATEGORY AND THE BASE OF BUSINESS WE HAD ESTABLISHED. THE MANAGEMENT OF OUR COMPANY, ALL THE WAY THROUGH GRANDMET, PROVIDED US WITH THE RESOURCES AND THE COMMITMENT TO PROTECT THIS IMPORTANT BASE OF BUSINESS FOR US. WE ENTERED THE PRICING WAR, EVEN THOUGH THERE WAS AVERAGE [sic] AN 8¢ DIFFERENCE IN OUR INCENTIVE PROGRAM AND BROWN & WILLIAMSON'S, WE FELT THAT OUR CREDIBILITY COULD MAKE UP THIS DIFFERENCE. WE ALSO FILED A LAW SUIT AGAINST BROWN & WILLIAMSON IN THE FEDERAL COURTS FOR TRADEMARK INFRINGEMENT, WRONGFUL PACKAGE IMITATION AND PREDATORY PRICING. OUR RETAIL PROGRAM INCLUDED BOTH FREE DISPLAYS AND THE ARRAY OF CONSUMER VOLUME PROMOTIONS THAT WE HAD USED IN THE DORAL PROGRAM. AGAIN, A TEAM EFFORT IS WHAT WAS NEEDED, AND A TEAM EFFORT IS WHAT WE RECEIVED AT BOTH RETAIL AND HEADQUARTER COVERAGE BY BOTH THE GARY AND LIGGETT FIELD ORGANIZATIONS. THE RESULTS OF THIS TEAM EFFORT WERE THAT WE MAINTAINED 80-85% OF THE TOTAL CATEGORY VOLUME DURING THE INTRODUCTORY PERIOD. BUT AGAIN, THE BATTLE SHIFTED TO RETAIL. WE ARE NOT ONLY FIGHTING DISTRIBUTION AND MERCHANDISING AT RETAIL THIS TIME BUT ALSO THE AWARENESS OF OUR GENERIC PRODUCT VERSUS THAT OF BROWN & WILLIAMSON WITH BOTH THE RETAILER AND THE CONSUMER.

SLIDE 10

WHILE THE BATTLE ON A DAY TO DAY OR WEEK TO WEEK BASIS IS HOT AND HEAVY, IT'S IMPORTANT THAT WE SOMETIMES SIT BACK AND LOOK AND SEE HOW THE ENTIRE WAR IS FAIRING [sic]. AT THE

END OF THE FIRST FISCAL QUARTER OF 1984, LIGGETT & MYERS' GENERIC AND PRIVATE LABEL PRODUCTS REPRESENTED OVER 3 1/2% OF THE BUSINESS FOR THE QUARTER AND WERE THE ENTIRE CATEGORY. NOT ONLY HAVE WE GROWN TO ALMOST A 4 SHARE OF MARKET FOR THE FOURTH QUARTER, BUT ALSO AS WE HAD HOPED, THE ENTIRE CATEGORY HAS GROWN TO OVER A 5 SHARE OF THE TOTAL CIGARETTE BUSINESS. ALSO, OUR FISCAL YTD SHARE OF MARKET EXCEEDED 4%. AS YOU CAN SEE FROM THE TOTAL INDUSTRY VOLUME FIGURES AT THE TOP OF THE CHART, THAT IN AN INDUSTRY THAT IS FLAT, TO SHOW GROWTH IS AN EXCITING ACCOMPLISHMENT. WE HAVE NOT ONLY MAINTAINED 80% OF A GROWING CATEGORY BUT HAVE ALSO SENT A MESSAGE OUT TO THE REST OF THE INDUSTRY THAT LIGGETT & MYERS CANNOT BE WALKED ON. THIS MESSAGE IS A RESULT OF THE ACCOMPLISHMENTS OF EVERYONE IN OUR ORGANIZATION AND A SPECIAL TRIBUTE TO OUR LIGGETT & GARY FIELD SALES ORGANIZATION.

SLIDE 11

AS DON MENTIONED EARLIER, TODAY'S CONSUMER IS CHANGING, AND WE ARE SEEING THIS CHANGE IN THE GENERIC/PRIVATE LABEL CONSUMER. THE PRIVATE LABEL MANUFACTURER'S ASSOCIATION 1984 GALLUP POLL RESEARCH INDICATES THAT: #1 - 80% OF CONSUMERS CONSIDER QUALITY VERY IMPORTANT IN THE DECISION TO BUY A STORE BRAND AND 74% PRICE. THIS SAYS THAT QUALITY IS AS IMPORTANT IN THE CONSUMER'S MIND AS LOWER PRICES. SECOND, 36% OF THE CONSUMERS SAY THEY ARE BUYING MORE STORE BRANDS THIS YEAR AND 42% EXPECT TO PURCHASE MORE NEXT YEAR. MORE PEOPLE TODAY THAN EVER BEFORE ARE WILLING TO LAY A STORE BRAND OR GENERIC BRAND ON THE TABLE AND SAY THIS IS THE BRAND THAT THEY SMOKE. AND THIRD, IT IS VERY INTERESTING THAT 53% OF THE CONSUMERS WOULD BE INFLUENCED

TO BUY STORE BRANDS IF THERE WAS A GUARANTEE OF SATISFACTION. THIS IS AN IMPORTANT ELEMENT THAT WE PLAN TO ADDRESS IN 1985. YANKELOVICH HAS ALSO TOLD US THAT WHILE THE PROLIFERATION OF GENERIC/PRIVATE LABEL BRANDS HAS INCREASED THE CONSUMER'S ALTERNATIVES, IT HAS DECREASED THE CONSUMER'S PERCEPTION OF QUALITY CONTINUITY. MR. OR MRS. CONSUMER IS CONCERNED THAT EACH TIME THEY MAKE A DECISION TO BUY A STORE BRAND OR A GENERIC BRAND THAT THE SAME QUALITY IS CONSISTENTLY THERE. WE FEEL THAT THE CONSISTENCY OF THE QUALITY OF LIGGETT & MYERS' STORE BRAND PRODUCTS IS SOMETHING THAT HAS TO CONTINUALLY BE DRIVEN HOME TO THE CONSUMER IN THE FUTURE.

SLIDE 12

COMPETITION AND THE CHANGING VALUES OF THE CONSUMER HAS ALSO CAUSED A CHANGE FOR THE TRADE. FIRST, COMPETITION IN THE GENERIC CATEGORY HAS NOW GIVEN THE TRADE A CHOICE. THEY NO LONGER HAVE TO WAIT FOR US, AND THEY HAVE THE OPPORTUNITY TO LEVERAGE COMPANY AGAINST COMPANY. WE HAVE TO BE THERE FIRST AND ON A CONSISTENT BASIS. SECOND, THE GROWTH OF THE GENERIC CATEGORY HAS INCREASED THE RETAIL INFLUENCE OF DIRECT ACCOUNT DISTRIBUTION. THE SHEER NUMBERS OF THE CONSUMERS IN THE GENERIC AND PRIVATE LABEL CATEGORY HAVE CREATED A VOICE, OR A MESSAGE, TO THE RETAIL ACCOUNT. THIS VOICE CAN MORE, NOW THAN EVER, INFLUENCE WHAT THE DIRECT ACCOUNTS WILL CARRY. THIRD, THERE HAS ALSO BEEN A TREND IN THE INDUSTRY TOWARDS UPGRADED GENERIC/PRIVATE LABEL PACKAGING. KENTON GAST, VICE PRESIDENT OF PROCUREMENT OF THE KROGER COMPANY, STATED THAT THE CONSUMER MUST SEE OUR PRIVATE LABEL PRODUCT AND ASSOCIATE IT WITH HIGH VALUE AND QUALITY. WHILE BLACK AND WHITE IS NOT DEAD, MORE CONSUMERS THAN EVER BEFORE ARE CONSIDERING

STORE BRAND PRODUCTS OR UPSCALE PACKAGING PRODUCTS TO BE THAT OF COMPARABLE VALUE AND QUALITY OF NATIONAL BRANDS.

SLIDE 13

THE CHANGE IN THE ENVIRONMENT HAS ALSO TOLD US THAT WE HAVE TO WORK DIFFERENTLY AS AN ORGANIZATION. THE CHANGING NATURE OF THE CATEGORY AND COMPETITION HAS INCREASED THE INTERDEPENDENCIES BETWEEN THE GARY ORGANIZATION AND THE LIGGETT ORGANIZATION AND THAT'S BOTH AT THE FIELD SALES LEVEL AND THE HEADQUARTER LEVEL. YES, BOTH SPECIALISTS AT THE RETAIL LEVEL AND THE HEADQUARTER LEVEL ARE IMPORTANT, BUT THE COMMUNICATION AND INFORMATION LINK BETWEEN THE TWO IS MORE IMPORTANT THAN IT EVER WAS BEFORE.

COMPETITION IS HERE TO STAY. WE HAVE TO DIRECT OUR RESOURCES TO WHAT WE CAN CONTROL. WE CANNOT CONTROL COMPETITION, BUT WE CAN CONTROL OUR PACKAGING, OUR PRICING, AND THE TASTE AND QUALITY OF OUR PRODUCT. OUR MIND'S SET, AS AN ORGANIZATION, HAS TO BE OFFENSIVE VERSUS DEFENSIVE - REALLY GEARED OR ZEROED INTO THOSE AREAS THAT WE CAN CONTROL. ALSO, OUR CHANGING ENVIRONMENT WILL INCREASE THE NEED FOR MANAGERS WHO UNDERSTAND THE ENVIRONMENT AND DECENTRALIZED DECISION MAKING FOR BOTH TIMELY ACTIONS AND REACTIONS.

SLIDE 14

WE HAVE WORKED HARD TO ENSURE THAT IN OUR GENERIC/PRIVATE LABEL ORGANIZATION WE ARE ORGANIZED TO MEET THE CHALLENGE OF CHANGE AND SUCCESS. OUR HEADQUARTERS STAFF IS COMPOSED OF DIDI HUNT, WHO HANDLES OUR MARKETING OPERATIONS; MIKE OSBORNE, IN CHARGE OF NATIONAL SALES; AND

4 NATIONAL ACCOUNT MANAGERS WHO HANDLE THE CORPORATE HEADQUARTER CALLS, INCLUDING STEVE KIRCHHOFF IN THE BROKER AREA; JOE MCGEE THE DISTRIBUTOR AREA; CHARLIE HARRISON, THE SUPERMARKET AREA; AND BRUCE PARSONS IN THE CONVENIENCE AND DRUG AREA. THIS TEAM NOT ONLY DEVELOPS OUR GENERIC/PRIVATE LABEL PROGRAMS BUT ALSO JOINTLY MAKE [SIC] THOSE DECISIONS NECESSARY TO CARRY ON THE DAY TO DAY OPERATIONS OF OUR BUSINESS AND MOVE US FORWARD. ALSO, WHILE WE MAY DEVELOP A PROGRAM IN HEADQUARTERS, THE DECISIONS ON HOW THAT PROGRAM IS EXECUTED AND IMPLEMENTED ARE MADE BY THOSE PEOPLE WHO ARE CLOSEST TO THE ACTION AND THAT IS BOTH THE GARY FIELD SALES ORGANIZATION AND THE LIGGETT FIELD SALES ORGANIZATION. WHILE EACH PIECE OF THE ORGANIZATION HAS ITS OWN RESPONSIBILITIES AND ACCOUNTABILITIES, THE TIE AND LINK BETWEEN THE TWO ARE NOW MORE IMPORTANT THAN IT EVER WAS BEFORE. I WOULD LIKE TO STOP HERE FOR JUST A SECOND AND COMMEND AND RECOGNIZE THIS FINE GROUP OF PEOPLE. DURING MY TRANSITION PERIOD INTO MY NEW POSITION, WHEN I COULDN'T FIND MY WAY TO THE BATHROOM, THESE ARE THE PEOPLE THAT MADE IT HAPPEN IN HEADQUARTERS. AND WHILE WE HAVE ALWAYS KNOWN THAT THESE PLAYERS ARE GOOD, IT HELPED PROVIDE ME WITH A SENSE OF CONFIDENCE THAT WE CAN MAKE IT HAPPEN.

SLIDE 15

WHILE OUR ENVIRONMENT WAS CHANGING RAPIDLY IN 1984, WE IMPLEMENTED AND EXECUTED SOME EXCITING MARKETING PROGRAMS THAT WE FEEL ARE HELPFUL FOR US TO BUILD A BASE FOR THE FUTURE.

SLIDE 16

AT THE BEGINNING OF 1984, WE ANNOUNCED OUR QUALITY SEAL PROGRAM. OUR MARKETING OBJECTIVE WAS TO MAINTAIN THE GARY TOBACCO COMPANY LEADERSHIP POSITION AMONG CONSUMERS. OUR STRATEGY WAS TO ESTABLISH GARY TOBACCO COMPANY GENERIC/PRIVATE LABEL CIGARETTES AS THE QUALITY GENERIC BRANDS. OUR CREATIVE OBJECTIVE WAS TO CONVINCE USERS OF GENERIC/PRIVATE LABEL CIGARETTES THAT GARY TOBACCO COMPANY CIGARETTES ARE THOSE OF QUALITY.

SLIDE 17

TO ANNOUNCE THE QUALITY SEAL, WE RAN A NATIONAL PROGRAM THAT INCLUDED SEVERAL ELEMENTS. FIRST OF ALL, WE RAN A NATIONAL ADVERTISING PROGRAM WITH FULL AND HALF PAGE NEWSPAPER ADS IN ALL MAJOR MARKETS DURING NOVEMBER, DECEMBER AND JANUARY. THIS AD VISUALLY PUT THE QUALITY SEAL IN FRONT OF THE CONSUMER.

SLIDE 18

BASED ON THE PREVIOUS EXPERIENCE WE HAD WITH OUR EXCISE TAX PROGRAM IN 1983, WE LEARNED THAT WE COULD GET THE RETAILER TO PARTICIPATE IN A NATIONAL ADVERTISING PROGRAM. NOT ONLY DID WE HAVE OVER 500 PARTICIPANTS IN OUR COOPERATIVE ADVERTISING PROGRAM, BUT MOST MAJOR RETAIL ORGANIZATIONS IN THE COUNTRY PARTICIPATED.

SLIDE 19

A COMPLETE LINE OF POINT OF SALE WAS DEVELOPED TO ANNOUNCE THIS PROGRAM AT THE RETAIL LEVEL. THIS INCLUDED

INSERTS FOR OUR PERMANENT MASS DISPLAYS, PERMANENT COUNTER DISPLAYS, AS WELL AS TEMPORARY POINT OF SALE. DURING THIS PERIOD, OVER 6800 ADDITIONAL PMD'S WERE PLACED AND 8300 PCD'S WERE PLACE.

SLIDE 20

OUR ADVERTISING PROGRAM WAS ALSO SUPPLEMENTED BY A FULL BLOWN PUBLIC RELATIONS EFFORT. THIS INCLUDED A PRESS CONFERENCE AND PRESS RELEASES TO MAJOR PUBLICATIONS ACROSS THE COUNTRY WHICH STIMULATED BOTH TRADE AND CONSUMER PUBLICATIONS TO RUN ARTICLES TOUTING THE QUALITY SEAL AND THE GROWTH OF THE GENERIC/PRIVATE LABEL CIGARETTE CATEGORY.

SLIDE 21

OUR PUBLIC RELATIONS EFFORT ALSO INCLUDED A FULL BLOWN EFFORT IN BROADCAST MEDIA. CBS RADIO DID AN INTERVIEW WITH K. V. DEY. IT WAS CARRIED ON BOTH AM STATIONS AND FM STATIONS ACROSS THE COUNTRY. THE NEWS-SPORTS RADIO NETWORK AIRED A NEWS BRIEF THAT RAN OVER 1200 TIMES AND REACHED A 17.3 MILLION NATIONWIDE AUDIENCE. THE NORTH AMERICAN PRESS SYNDICATE RAN A NEWS BRIEF THAT 229 STATIONS CARRIED TO OVER A 13 MILLION AUDIENCE AND A TV VIDEO QUIP WAS DEVELOPED THAT AIRED ON 15 STATIONS REACHING OVER A 2¹/₂ MILLION AUDIENCE. IF I CAN NOW, I WOULD LIKE TO TAKE JUST A MOMENT TO PLAY THE CBS INTERVIEW WITH K. V. DEY.

SLIDE 22

OUR SECOND MAJOR THRUST AGAINST THE QUALITY SEAL WAS A SPONSORSHIP IN THE 1984 LOUISIANA WORLD'S FAIR. OUR OBJECTIVE WAS AGAIN TO INCREASE THE CONSUMER AWARENESS OF

LIGGETT & MYERS' QUALITY SEAL GENERIC CIGARETTES. OUR STRATEGY WAS TO USE A MAJOR EVENT, SUCH AS THE LOUISIANA WORLD'S FAIR, AS A STIMULUS, OR WE MIGHT CALL IT A SWIZZLE STICK, TO INCREASE THE TRADE PARTICIPATION AND OWNERSHIP IN THE QUALITY SEAL. WHEN A RETAILER CARRIED QUALITY SEAL GENERICS OR STORE BRAND CIGARETTES, HE WAS IN ESSENCE CARRYING THE OFFICIAL CIGARETTE OF THE 1984 LOUISIANA WORLD'S FAIR. OUR INVOLVEMENT INCLUDED SPONSORSHIP OF THE INTERNATIONAL AMPHITHEATRE, WHICH WOULD HOST TOP NAME ENTERTAINMENT THROUGHOUT THE DURATION OF THE FAIR; A COOPERATIVE ADVERTISING PROGRAM, WHICH TIED RETAILERS INTO THE WORLD'S FAIR; MASS SAMPLING AT THE FAIR; THEME RELATED POINT OF SALE FOR RETAIL, AND AGAIN A FULL BLOWN PUBLIC RELATIONS CAMPAIGN.

SLIDE 23

AS YOU CAN SEE, THE AMPHITHEATRE WAS A MASSIVE STRUCTURE BUILT FOR THE WORLD'S FAIR THAT CARRIED PLENTY OF RECOGNITION FOR LIGGETT & MYERS AND THE QUALITY SEAL.

SLIDE 24

THE STAGE OF THE AMPHITHEATRE ALSO CARRIED THIS SAME RECOGNITION FOR LIGGETT & MYERS AND THE QUALITY SEAL. NO MATTER WHERE A PICTURE WAS TAKEN INSIDE THE AMPHITHEATRE, RECOGNITION AND EXPOSURE OF THE QUALITY SEAL WAS ALWAYS THERE.

SLIDE 25

AS YOU FLEW INTO NEW ORLEANS AND PASSED OVER THE WORLD'S FAIR, THE QUALITY SEAL WAS ALSO VISIBLE ON THE TOP

OF THE AMPHITHEATRE. I CAN ALSO GUARANTEE YOU THAT WHILE WE HAVE A TOUGH ORGANIZATION, THERE WAS NO ONE IN OUR ORGANIZATION THAT WAS TOUGH ENOUGH TO GO ON THE TOP OF THE AMPHITHEATRE AND PAINT THE QUALITY SEAL UP THERE.

SLIDE 27

BERT PARKS, OF MISS AMERICA FAME, WAS CHOSEN AS THE OFFICIAL SPOKESPERSON AND ANNOUNCER FOR THE LIGGETT & MYERS QUALITY SEAL AMPHITHEATRE. BERT WAS AN ADMIRABLE HOST TO THE TOP NAME ENTERTAINMENT THAT CAME IN TO PERFORM AT THE WORLD'S FAIR. BERT RECEIVED HIGH MARKS, NOT ONLY BEING A GREAT HOST, BUT ALSO A FUN PERSON TO WORK WITH. AN INTERESTING POINT IS ALSO THAT DURING THE ENTIRE PERIOD IN WHICH MAJOR ENTERTAINMENT APPEARED IN THE AMPHITHEATRE, IT WAS *SOLD OUT!*

SLIDE 28

OUR COOPERATIVE ADVERTISING EFFORT WITH THE RETAILERS AGAIN PROVED TO BE VERY SUCCESSFUL. THE LOUISIANA WORLD'S FAIR AND OUR SPONSORSHIP WITH THE AMPHITHEATRE STIMULATED WHAT WAS NEEDED TO GET RETAILERS TO GIVE THEIR TOTAL SUPPORT TO THE PROGRAM. AGAIN, WE HAD OVER 500 PARTICIPANTS IN OUR COOPERATIVE ADVERTISING EFFORT.

SLIDE 29

A SPECIAL PACK OF QUALITY SEAL GENERIC CIGARETTES WAS DEVELOPED AS THE OFFICIAL CIGARETTE OF THE WORLD'S FAIR AND OVER 700,000 SAMPLE PACKS WERE PASSED OUT DURING THE DURATION OF THE FAIR.

SLIDE 30

A COMPLETE LINE OF THEME POINT OF SALE SHOWING THE WORLD'S FAIR LOGO ALONG WITH THE QUALITY SEAL WAS DEVELOPED FOR ALL OF OUR PLACEMENTS AT RETAIL.

SLIDE 31

OUR PUBLIC RELATIONS EFFORT INCLUDED A PRESS KIT THAT WAS SENT TO NATIONAL AND LOCAL PUBLICATIONS. THE STORY OF THE WORLD'S FAIR, BERT PARKS AND LIGGETT & MYERS' INVOLVEMENT WENT ACROSS THE COUNTRY.

SLIDE 32

OUR PUBLIC RELATIONS EFFORT ALSO AGAIN INCLUDED BROADCAST MEDIA. EVENTS SUCH AS THE SPONSORSHIP ANNOUNCEMENT, THE BERT PARKS HOSTING ANNOUNCEMENT, BERT PARKS' INTERVIEW AND TOUR ACROSS THE COUNTRY, INCLUDING THE KABC-TV HOUR MAGAZINE, AND A JULY 4TH SPECIAL AT THE AMPHITHEATRE ALL PROVIDED EVENTS THAT WERE NEWSWORTHY FOR LIVE MEDIA. THE RESULTS WERE THAT WE HAD OVER 1500 RADIO SPOTS AT A 60 SECOND AVERAGE WHERE LIGGETT & MYERS AND/OR THE QUALITY SEAL WERE MENTIONED - OVER 40 TV SPOTS - REACHING A COMBINED AUDIENCE OF OVER 20 MILLION VIEWERS AND LISTENERS. I WOULD NOW LIKE TO SHOW YOU A VIDEO TAPE THAT SUMMARIZES OUR SUCCESS AT THE 1984 LOUISIANA WORLD'S FAIR.

(PLAY VIDEO TAPE.)

WHILE THE WORLD'S FAIR ITSELF MAY HAVE HAD MIXED REVIEWS, WE GIVE IT HIGH MARKS IN HELPING US CARRY OUR Q-SEAL MESSAGE.

SLIDE 33

IN JUNE, WE ALSO EXTENDED OUR PRODUCT LINE TO INCLUDE BOTH FULL FLAVOR KING SIZE AND FULL FLAVOR 100's, AND AS YOU CAN SEE FROM THIS CHART, AFTER INITIAL PIPELINE FIGURES IN JUNE AND JULY, FULL FLAVOR SALES HAVE CONTINUALLY GROWN TO OVER 14,000 CASES IN SALES IN THE MONTH OF OCTOBER.

SLIDE 34

1984 WAS A BUSY, EXCITING YEAR FOR ALL OF US, BUT THE PROOF IS ALWAYS IN RESULTS. OUR OBJECTIVE OF 23 BILLION UNITS WAS EXCEEDED BY SHIPPING 23.9 BILLION UNITS FOR THE FISCAL YEAR. OUR OBJECTIVE OF A 3.6 SHARE OF MARKET WAS EXCEEDED BY GROWING TO OVER A 4% SHARE OF MARKET FOR FISCAL 1984. THESE POSITIVE RESULTS AND GROWTH PROVIDE US WITH A BASE TO MOVE AHEAD IN 1985.

SLIDE 35

WHAT ARE THE ISSUES FOR 1985 AS WE MOVE FORWARD IN THE GENERIC/PRIVATE LABEL PROGRAM? FIRST OF ALL THE TOTAL CATEGORY - WILL IT GROW? WE FEEL CONFIDENT IT WILL. WILL CURRENT OR NEW COMPETITION INCREASE THIS GROWTH? WHAT WILL BE THE IMPACT OF NEW PRICING TIERS ON THE GROWTH OF THE GENERIC/PRIVATE LABEL CATEGORY. WE FEEL THAT BOTH ACTIVITY BY THE INDUSTRY AND THE CHANGING VALUES OF THE CONSUMER WILL CAUSE THIS CATEGORY TO CONTINUALLY GROW. SECOND, LIGGETT & MYERS GENERIC/PRIVATE LABEL/CONSUMER AWARENESS - A KEY ISSUE FOR 1985 - BUT WE DO HAVE A DIFFERENCE - THE QUALITY SEAL AND WE PLAN TO DRIVE QUALITY SEAL FORWARD IN 1985. THIRD, IN PROTECTING OUR CURRENT USER BASE AND LIGGETT GENERIC/PRIVATE LABEL AVAILABILITY,

RETAIL MERCHANDISING AND DIRECT ACCOUNT AVAILABILITY ARE BOTH KEY ELEMENTS. WE HAVE TO BE PREPARED FOR THE BATTLE FOR BOTH DISTRIBUTION AND MERCHANDISING SPACE ON OUR PRODUCTS IN 1985.

SLIDE 36

WE ARE INVESTING A TREMENDOUS AMOUNT OF RESOURCES IN OUR GENERIC/PRIVATE LABEL PROPOSITION IN 1985 BECAUSE WE FEEL CONFIDENT THAT THE CATEGORY WILL CONTINUE TO GROW. IN 1983, THE CATEGORY SHOWED 178% INCREASE OVER THE PREVIOUS YEAR. IN 1984, A 82% INCREASE. IF THE CATEGORY CONTINUES TO GROW JUST AT THE SAME RATE, IT CAN BE CLOSE TO 50 BILLION UNITS BY 1988. PEOPLE OUTSIDE OUR COMPANY ALSO FEEL IT WILL GROW. JOHN MAXWELL, INDUSTRY ANALYST, SAYS IT WILL BE 10-12% SHARE OF MARKET BY 1985, SAMUEL BERNSTEIN OF BERNSTEIN RESEARCH, A FINANCIAL ANALYST, SAID 5 1/2-6% BY 1984 [sic] AND 10-12% BY 1988. EVEN R.J. REYNOLDS, ONE OF OUR MAJOR COMPETITORS, HAS STATED THAT THE GENERIC CATEGORY WILL REPRESENT 7-10% OF THE TOTAL CIGARETTE MARKET. YES, WE DO FEEL THE GENERIC CATEGORY WILL GROW AND WE CAN GROW WITH IT.

SLIDE 37

OUR OBJECTIVE FOR 1985 IS TO MAINTAIN THE MAJOR SHARE OF THE GENERIC/PRIVATE LABEL CATEGORY WITH PROGRAMS THAT COMBAT COMPETITIVE ENTRIES AND BUILD OUR CONSUMER FRANCHISE. OUR VOLUME OBJECTIVE IS 26 BILLION UNITS, WHICH REPRESENTS AN 8.7% INCREASE OVER OUR 1984 RESULTS. NOW LET'S TAKE SOME TIME TO TALK ABOUT EACH OF OUR STRATEGIES.

SLIDE 38

EVEN THOUGH OUR DIRECT ACCOUNT PROGRAM IS COSTLY, IT'S A NECESSARY EVIL IN ORDER TO MAINTAIN DISTRIBUTION AT THE IMPORTANT DIRECT ACCOUNT LEVEL. WE ARE PREPARED TO EMPLOY OUR TACTICS TO COMBAT ENTRIES AT THE DIRECT ACCOUNT LEVEL INCLUDING CONTRACT INCENTIVES, A CONTRACT BONUS, OUR DIRECT ACCOUNT VOLUME INCENTIVES AS WE NEED IN 1985 TO FIGHT THE COMPETITIVE ONSLAUGHT. ANOTHER IMPORTANT ELEMENT OF OUR DIRECT ACCOUNT PROGRAM IS TO ENSURE THAT OUR COVERAGE OF DIRECT ACCOUNTS IS FREQUENT ENOUGH TO NOT ONLY MEET THE NEEDS OF THE CHANGING ENVIRONMENT BUT TO ALSO MEET THOSE NEEDS CAUSED BY COMPETITION. LIGGETT'S SALES ORGANIZATION HAS AND WILL PLAY A VITAL ROLE IN HELPING US ENSURE THAT WE GET THE PROPER COVERAGE ON OUR HEAD-QUARTER ACCOUNTS.

SLIDE 39

IN OCTOBER, WE KICKED OFF OUR FALL CONSUMER RETAILER VOLUME PROMOTION WHICH WE ARE CURRENTLY INVOLVED WITH. THIS PROGRAM INCLUDES DOLLAR OFF STICKERING, 2 PACKS FREE WITH A CARTON, AND BUY 4 PACKS GET 1 FREE. THE SELLING BROCHURE, AS WELL A FULL LINE OF POINT OF SALE, WERE DEVELOPED FOR THIS PROGRAM AND ARE CURRENTLY BEING PLACED AT RETAIL. WHILE THIS KIND OF A PROGRAM DOESN'T STRESS FOR NEW TRIAL AND AWARENESS, IT IS A GOOD DEFENSIVE STRATEGY TO HELP US WITH RETAILERS AND CONSUMERS DURING THIS COMPETITIVE BATTLE.

SLIDE 40

DRIVING HOME AWARENESS OF OUR QUALITY SEAL IS MORE IMPORTANT IN 1985 THAN IT EVER HAS BEEN BEFORE. EVEN THOUGH ALL

BLACK AND WHITES MAY LOOK THE SAME, THE QUALITY SEAL CAN GIVE THE RETAILER AND THE CONSUMER THE ASSURANCE THAT QUALITY SEAL REPRESENTS THE ORIGINAL AND ACCEPTED QUALITY GENERIC CIGARETTE. IN '85, WE ARE MOVING AHEAD WITH PUTTING THE QUALITY SEAL ON OUR CARTONS, DEVELOPING A QUALITY SEAL SLOGAN, DEVELOPING THE QUALITY SEAL CONSUMER GUARANTEE, AND A SPRING PROMOTION TO FURTHER ENHANCE OUR AWARENESS OF QUALITY SEAL.

SLIDE 41

THE SIMILARITY BETWEEN BROWN AND WILLIAMSON'S CARTON PACKAGING AND OUR CARTON PACKAGING HAS INCREASED THE NEED TO BRING A POINT OF DIFFERENCE INTO OUR PACKAGING, AND THAT DIFFERENCE IS PUTTING THE QUALITY SEAL ON THE CARTON. WE HAVE ALREADY RECEIVED APPROVAL FROM ACCOUNTS THAT REPRESENT OVER 72% OF OUR BUSINESS TO PUT QUALITY SEAL ON THEIR CARTONS, AND THIS INCLUDES THE BRANDS THAT WE OWN, CLASS 'A' AND FRANCHISE, AND ALSO OUR BROKER BRANDS. SOME OF OUR TOP PRIVATE LABEL CUSTOMERS IN THE COUNTRY HAVE ALSO GIVEN US APPROVAL TO MOVE AHEAD AND PUT QUALITY SEAL ON THE CARTON. ALL OF OUR CUSTOMERS WHO HAVE LABELS PRODUCED BY US WILL BE CONTACTED AND SOLD THIS CONCEPT. I'M SURE YOU ARE ALL ALSO AWARE THAT WE MAINTAIN INVENTORIES OF CARTONS IN DURHAM, AND WE ARE WORKING AS HARD AS WE CAN TO GET QUALITY SEAL ON THE CURRENT INVENTORIES WE HAVE AND DEVELOP NEW CARTONS AS WE DEplete THESE FOR ALL OF THE BRANDS WE PRODUCE. OUR GOAL IS TO HAVE QUALITY SEAL ON ALL OF THE CARTONS AT RETAIL BY JANUARY 1985.

SLIDE 42

WHILE WE'VE DONE A GOOD JOB IN 1984 OF DEVELOPING AND PROMOTING THE QUALITY SEAL, WE DID LEARN THAT OUR QUALITY

SEAL AWARENESS WAS NOT AS HIGH AS WE WOULD LIKE IT TO BE. THERE IS A NEED TO DEVELOP A STRAIGHT-FORWARD, HARD-HITTING SLOGAN THAT REALLY COMMUNICATED THE MESSAGE OF THE QUALITY SEAL - SOMETHING THAT THE CONSUMER WOULD REMEMBER. THE SLOGAN, "THERE IS NO SUBSTITUTE FOR QUALITY," WAS DEVELOPED TO BE USED ON ALL FUTURE ADVERTISING AND PROMOTIONS. WE HOPE THIS SLOGAN CAN BECOME ANOTHER "COKE IS IT" FOR THE GENERIC/PRIVATE LABEL CIGARETTE INDUSTRY.

SLIDE 43

AS WE DISCUSSED EARLIER, TODAY'S GENERIC/PRIVATE LABEL CONSUMER IS MORE CONCERNED THAN EVER OVER THE QUALITY OF GENERIC/PRIVATE LABEL PRODUCTS. THEY'VE ALSO EXPRESSED THAT A GUARANTEE OF SATISFACTION, OR QUALITY, COULD INFLUENCE THEIR PURCHASE OF GENERIC/PRIVATE LABEL PRODUCTS. OUR QUALITY SEAL CONSUMER GUARANTEE, WE FEEL, HELPS ANSWER THOSE NEEDS AS WELL AS ANOTHER STEP TOWARD INCREASING THE AWARENESS OF THE QUALITY SEAL. WE WANT TO ENSURE THE CONSUMER THAT THE QUALITY SEAL GENERIC CIGARETTES ARE OF THE FINEST QUALITY. THE ELEMENTS OF THIS PROGRAM ARE A PACK BACK GUARANTEE TO THE CONSUMER, IF FOR ANY REASON, THEY ARE DISSATISFIED WITH THE QUALITY OF QUALITY SEAL GENERIC OR STORE BRAND CIGARETTES. WE WILL BACK THIS WITH NATIONAL ADVERTISING NOVEMBER THROUGH FEBRUARY. BASED ON OUR PREVIOUS SUCCESS WITH RETAILER ADVERTISING, WE WILL AGAIN GIVE OUR RETAILERS THE OPPORTUNITY TO PARTICIPATE IN THIS PROGRAM. WE WILL ALSO HAVE A HARD-HITTING TRADE ADVERTISING PROGRAM AS WELL AS A FULL BLOWN PUBLIC RELATIONS CAMPAIGN AND POINT OF SALE THAT TOUTS THE QUALITY SEAL CONSUMER GUARANTEE. OUR QUALITY GUARANTEE IS A FIRST FOR OUR INDUSTRY AND ONE OF THE FEW PRODUCT GUARANTEES IN THE

ENTIRE GENERIC/PRIVATE LABEL CATEGORY. WE FEEL THAT THIS IS ANOTHER EXAMPLE OF OUR LEADERSHIP AND INNOVATION.

SLIDE 44

OUR NATIONAL ADVERTISING PROGRAM WILL RUN THROUGH FEBRUARY IN *USA TODAY* AND *NATIONAL ENQUIRER* WITH OVER 100 MILLION IMPRESSIONS, "QUALITY GUARANTEED - LOOK FOR THE 'Q' AND BE SURE." WE FEEL CONFIDENT THAT BOTH THE COPY AND THE GRAPHIC TREATMENT OF THE QUALITY SEAL IN THIS AD WILL HELP US GET OUR MESSAGE ACROSS THAT QUALITY SEAL GENERIC CIGARETTES ARE THE QUALITY CHOICE.

SLIDE 45

RETAILER ADS HAVE BEEN DEVELOPED FOR THIS PROGRAM TO GIVE RETAILERS THE OPPORTUNITY TO PARTICIPATE IN THE QUALITY GUARANTEE PROGRAM. A SUPPLY OF THESE ADS HAS BEEN SENT BOTH TO FIELD PERSONNEL AND ARE AVAILABLE IN ADDITIONAL QUANTITIES HERE IN DURHAM.

SLIDE 46

LETTING THE TRADE KNOW THAT THERE IS A DIFFERENCE IS A VERY IMPORTANT ELEMENT OF OUR QUALITY SEAL GUARANTEE PROGRAM. THIS AD WITH K. V. ANNOUNCING OUR QUALITY GUARANTEE PROGRAM TO THE TRADE WILL BE RUN IN ALL MAJOR TRADE PUBLICATIONS THROUGHOUT THE DURATION OF THE PROGRAM. WHO CAN THINK OF A BETTER PERSON TO SAY, "OUR QUALITY GUARANTEE STANDS FOR SALES AND PROFITS WITH A CAPITOL Q." WE FEEL THAT BOTH K. V.'S CREDIBILITY WITH THE TRADE AND HIS MESSAGE WILL HAVE IMPACT IN OUR TRADE ADVERTISING.

SLIDE 47

WE WILL SUPPORT OUR QUALITY SEAL GUARANTEE WITH A FULL BLOWN PUBLIC RELATIONS EFFORT. THE CAMPAIGN INCLUDES A NEWS CONFERENCE HELD IN DURHAM TO ANNOUNCE THE QUALITY GUARANTEE TO THE MEDIA WITH A PRESS KIT THAT WENT OUT TO ALL MAJOR AND LOCAL PUBLICATIONS IN THE COUNTRY. ADDITIONALLY, A CONSULTANT OR SPOKESPERSON IS BEING SELECTED TO SERVE AS A CONSUMER REPORTER FOR LIGGETT & MYERS. THIS CONSULTANT WILL BE A QUALITY EXPERT TO ADDRESS THE CONSUMER ON A NATIONAL TOUR WITH GROUPS OF CONSUMERS WHO ARE CONCERNED ABOUT QUALITY. WE FEEL THIS WILL ALSO GIVE PLAY IN THE DOLLAR-WISE SECTIONS OF NEWSPAPERS.

SLIDE 48

OUR CONSUMER GUARANTEE PROGRAM ALSO INCLUDES A FULL ARRAY OF BOTH SELLING MATERIALS AND POINT OF SALE TO GET THE QUALITY SEAL MESSAGE AND CONSUMER GUARANTEE ACROSS AT THE POINT OF PURCHASE. WE FEEL WE HAVE AN IMPORTANT STORY OR MESSAGE TO TELL THE RETAILER AND THE CONSUMER, AND THESE SELLING AND POINT OF SALE MATERIALS WILL HELP US DO THAT.

SLIDE 49

WE ARE NOT GOING TO STOP HERE ON QUALITY SEAL. WE FEEL THAT WE HAVE A CONSISTENT MESSAGE THAT WE CAN TELL. WE ARE CURRENTLY DEVELOPING A PROGRAM FOR THE SPRING THAT WILL AGAIN DRIVE HOME THE QUALITY SEAL MESSAGE TO THE CONSUMER. WE WANT A CONSUMER PROMOTION THAT CREATES SOME TRIAL BUT STRONG AWARENESS OF THE QUALITY SEAL. WE HOPE TO START THIS PROGRAM IN MARCH AND RUN IT THROUGH

JUNE. WE THINK IT'S IMPORTANT THAT THIS PROGRAM REINFORCES THE AWARENESS OF QUALITY SEAL, REINFORCES THE SMART SHOPPER CONCEPT AND CAN PHYSICALLY INVOLVE THE CONSUMER WITH THE QUALITY SEAL IN SOME FORMAT.

SLIDE 50

WE HAVE ALSO LEARNED THAT INCREASING THE NUMBER OF STYLES WE HAVE AVAILABLE ON OUR GENERIC/PRIVATE LABEL PRODUCTS CAN HELP US TO INCREASE OUR BUSINESS. OUR CURRENT STYLES REPRESENT AND APPEAL TO APPROXIMATELY 72% OF THE TOTAL CIGARETTE CONSUMPTION. WE FEEL THAT INCREASING STYLE AVAILABILITY CAN CAPITALIZE TO A BROADER BASE OF CONSUMERS, AND FULL FLAVOR MENTHOL CURRENTLY OFFERS THE BEST OPPORTUNITY FOR US FOR EXPANSION. FIRST OF ALL, THE SIZE OF THE MARKET IS SIGNIFICANT, AND WE ALSO THINK THAT IT IS A GOOD COMPETITIVE MOVE TO CATCH OUR COMPETITION WITH A FULL FLAVOR MENTHOL WHILE THEIR EFFORTS ARE BEING PUT IN OTHER AREAS.

SLIDE 51

AS YOU CAN SEE FROM THIS CART, THE TOTAL MENTHOL CATEGORY, WHILE IT HAS NOT GROWN, HAS REMAINED COMPARATIVELY STABLE OVER THE PAST FEW YEARS. FULL FLAVOR MENTHOL REPRESENTS 48.6% OF THE MENTHOL CATEGORY OR ALMOST HALF THE TOTAL MENTHOL SALES, AND THIS REPRESENTS 13.4% OF THE TOTAL INDUSTRY VOLUME. WE THINK THAT'S A SIGNIFICANT CHUNK OF VOLUME THAT WE CAN GO AFTER.

SLIDE 52

IN LOOKING AT 1984 TOP 10 FULL FLAVOR MENTHOL BRANDS, YOU CAN SEE THAT THE TOP 10 BRANDS REPRESENT 97% OF THE TOTAL

FULL FLAVOR MENTHOL VOLUME. WE ALSO FEEL THAT, BASED ON THE SUCCESS OF NEWPORT, BOTH KOOL AND SALEM ARE VULNERABLE AND THAT WE CAN GET A SIGNIFICANT PIECE OF BUSINESS FROM THESE BRANDS. THE AVERAGE TAR LEVEL OF THESE TOP BRANDS IS IN THE 16 TO 17 MG. OF TAR LEVEL, AND THE TIPPING SKEWS TOWARDS CORK TIPPING ON THE KING SIZE AND WHITE TIPPING ON THE 100's.

SLIDE 53

WE ARE READY TO ROLL ON OUR FULL FLAVOR MENTHOL. THE PRODUCT IS 16 MG. OF TAR WITH CORK TIPPING ON OUR KING SIZE AND WHITE TIPPING ON THE 100's. WE PLAN TO HAVE CLASS 'A' READY TO SHIP IN MID-DECEMBER, OUR BROKER AND FRANCHISE BRANDS READY TO SHIP IN JANUARY AND BEGINNING IN FEBRUARY, IN SELLING AND SHIPPING OUR PRIVATE LABELS OUT. YOU WILL BE RECEIVING SHORTLY A FULL LINE OF BOTH SELLING MATERIALS AND POINT OF SALE TO SUPPLEMENT THIS ENTRY.

SLIDE 54

THE FIGHT FOR SPACE IN 1985 TO KEEP OUR PRODUCT AVAILABLE TO THE CONSUMER WILL BE HOT. WE FEEL THAT IT'S VERY IMPORTANT THAT WE REMAIN FLEXIBLE AND AGGRESSIVE IN DEVELOPMENT OF OUR MERCHANDISING CONCEPTS. WE FIRST OF ALL WANT TO ENSURE THAT WE PROPERLY UTILIZE AND MANAGE THE CURRENT FIXTURES WE HAVE AT RETAIL AND THAT INCLUDES OVER 67,000 PMD's AND 83,000 PCD's. THIS INCLUDES TIMELY P.O.S. FOR THESE RACKS AS WELL AS FAST TURNAROUND ON ORDERS. WE'RE PREPARED TO MEET COMPETITION WITH OUR FREE RACK PROGRAM, AND WE'RE PREPARED TO EXTEND THAT PROGRAM AS WE NEED. ADDITIONALLY, WE'RE PREPARED TO ORDER ADDITIONAL RACKS AS NEEDED DURING 1985 TO BE SURE WE'RE THERE AT RETAIL FOR THE

CONSUMER. ALSO, THE ONSLAUGHT OF NEW RACKS FROM R. J. REYNOLDS, FROM BROWN & WILLIAMSON, AND FROM OUR OWN STRIDE PROPOSITION IS CREATING PRESSURE ON THE RETAILER TO MAKE A DECISION WHERE HE IS GOING TO HOUSE THESE NEW ENTRIES. IT IS VERY IMPORTANT THAT WE CONTINUE TO DEVELOP NEW CARTON AND PACKAGE FIXTURES TO ENSURE AVAILABILITY AND COMBAT COMPETITION AND ALSO MEET THE NEEDS OF THE RETAILER. THE FIRST STEP WE'VE TAKEN IN THIS DIRECTION IS TO DEVELOP WHAT WE CALL A UNIVERSAL CARTON FIXTURE. WE'VE DEVELOPED 100 OF THESE RACKS WHICH ARE BEING TESTED OCTOBER THROUGH DECEMBER, AND WE ARE PREPARED TO EXPAND THESE NATIONALLY IF THE CONCEPT PROVES SUCCESSFUL.

SLIDE 55

THE 2 PROTOTYPES OF THIS UNIVERSAL RACK SHOWN HERE IN THIS PICTURE HOLD FROM 165 CARTONS TO 700 CARTONS. WE FEEL THAT THIS RACK CAN BECOME THE ALTERNATIVE CIGARETTE PRICING CENTER FOR THE RETAILER WHO HAS THE SPACE DEMANDS CREATED BY PRICE SEGMENTATION AND NEW BRANDS. THE EFFORTS AND THE FEEDBACK FROM THOSE OF YOU INVOLVED IN THIS TEST IS VERY IMPORTANT TO ENSURING THAT THIS CONCEPT IS ON TARGET.

SLIDE 56

AS YOU CAN SEE, WE HAVE AN AGGRESSIVE ATTACK PLANNED FOR 1985 IN THE GENERIC/PRIVATE LABEL AREA. WHILE IT WILL BE A BUSY YEAR FOR ALL OF US, IT IS IMPORTANT TO HAVE THE ENTIRE YEAR COVERED TO ENSURE THAT WE MEET THE CHALLENGE OF SUCCESS.

SLIDE 57

THE CHALLENGE OF SUCCESS FOR GENERIC/PRIVATE LABEL GOES BEYOND 1985. FOR THE FUTURE, WE THINK THERE'S SOME OTHER AREAS THAT ARE IMPORTANT THAT WE ADDRESS. FIRST OF ALL, WE WANT TO LOOK AT DEVELOPING AN UPSCALE COMMON PRIVATE LABEL AND REALLY WHAT WE'RE SAYING IS THAT IF THERE'S A TREND TOWARD UPSCALE PACKAGING IN THE INDUSTRY, WE WANT TO BE THERE FIRST. WE ALSO FEEL THAT IF WE SEGMENT THIS GENERIC BUSINESS, IT WILL BE TOUGHER AND TOUGHER FOR COMPETITION TO COME INTO IT. WE'LL ALSO CONTINUE TO LOOK AT STYLE AVAILABILITY. NON-FILTERS, WHICH ARE CURRENTLY IN MILITARY AND TEST WITH ASHLAND PETROLEUM COMPANY, WILL BE CONTINUALLY MONITORED TO SEE IF WE CAN ROLL ON A REGIONAL BASIS; ULTRA MENTHOL, WHICH IS BEING TESTED AND SOLD IN THE MILITARY CLASS OF TRADE - WE WILL CONTINUALLY LOOK AT THAT; AND THE BOX CATEGORY, WHICH REPRESENTS OVER 14% OF THE TOTAL INDUSTRY VOLUME, REPRESENTS A CATEGORY THAT WE WILL CONTINUE TO EXPLORE. ADDITIONALLY, WE'RE NOT GOING TO BACK OFF OF OUR QUALITY SEAL PROGRAM. WE THINK QUALITY SEAL IS OUR POINT OF DIFFERENCE AND A WAY THAT WE CAN DRIVE HOME THAT WE HAVE THE ORIGINAL AND ACCEPTED GENERIC/PRIVATE LABEL PRODUCT TO THE CONSUMER.

SLIDE 58

YES, WE FEEL CONFIDENT THE GENERIC/PRIVATE LABEL CATEGORY WILL CONTINUE TO GROW AND THAT LIGGETT & MYERS GENERIC/PRIVATE LABEL PROPOSITION CAN GROW WITH IT. WE FEEL THAT WE HAVE THE FLEXIBILITY AND THE CREATIVITY TO REALLY SEGMENT THIS GENERIC/PRIVATE LABEL CATEGORY AND GROW WITH IT AS IT

GROWS. AND MOST IMPORTANTLY, WE THINK THAT WE CAN CONTROL OUR DESTINY. WE HAVE THE WHEREWITHAL TO GROW AND, MOST IMPORTANTLY, TO GROW PROFITABLY. THANK YOU.

FISCAL 1988 CATEGORY SALES PROJECTIONS

CATEGORY AND L&M

(BILLIONS OF UNITS)

ANNU- ALIZED GROWTH THROUGH	1988	1988	1988 L&M		
	CATEGORY	CATEGORY	VOLUME		
	<u>1988</u>	<u>S.O.M.*</u>	<u>85%</u>	<u>75%</u>	<u>65%</u>
	19.4%	46.2	8%	39.3	34.7 30.0
	41.7%	69.4	12%	59.0	52.1 45.1
	58.4%	86.7	15%	73.7	65.0 56.4

* BASED ON TOTAL INDUSTRY SALES OF 578 BILLION UNITS FISCAL 1988

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* * *

Spending Principles

To spend competitively to achieve the 8.6 billion sticks.

Plans are to continue the following rebates in the domestic market for the first half of 1985:

- Volume rebate
- Prompt contract rebate
- Promotional allowance
- Fixtures
- Special promotion/contingency fund

On July 1, 1985, only the volume rebate and special promotion/contingency fund are scheduled to continue. Specific uses for promotion monies are still under discussion.

1985 Preliminary Generic Financials
(per M basis)

Net Selling Price	\$18.86
Total Variable Cost	<u>14.38</u>
Variable Margin	\$4.48

Rebates:

Volume	\$2.42
Prompt Contract	.24
Promotion	.24
Fixtures	.20
Special Promotion/Contingency	<u>1.00</u>
	\$4.10

Overhead	\$.38
Trading Profit	-

In the Military, the current offer, \$3.15 for kings and \$3.35 for 100's, is a straight fixed price.

Continue to spend by customer according to volume. The following table details how different volume classifications compare in terms of rebates.

[LOGO]
STRIDE

FEBRUARY 20, 1985

STRIDE SALES HAVE COME FROM
FULL-PRICE BRANDS

- STRIDE GREW FROM THE JULY INTRODUCTION TO .5 SHARE OF TOTAL CIGARETTE SALES IN DECEMBER.
- DORAL, A DIRECT PRICE COMPETITOR TO GENERICS, GREW FROM .3 SHARE IN JULY TO A .7 SHARE IN DECEMBER. DORAL HAS PROBABLY HURT THE GROWTH OF GENERIC SALES.
- CENTURY, ALSO INTRODUCED IN JULY, GREW TO .6 SHARE OF CIGARETTE SALES THROUGH HEAVY PACK/CARTON TRIAL OFFERS.
- GENERIC SALES GREW +.6 SHARE (3.1 SHARE JULY TO 3.7 SHARE DECEMBER) BUT SUFFERED DURING SEPTEMBER AND OCTOBER FROM THE CONSUMER TRIAL OFFERS USED IN THE INTRODUCTION OF STRIDE, DORAL AND CENTURY.
- HALF OF ALL STRIDE SMOKERS CLAIM TO HAVE BEEN MARLBORO, WINSTON, SALEM OR KOOL CONSUMERS WHILE ONLY 5% SAID THEY WERE GENERIC SMOKERS.

WLM:BP

WHERE TASTE RUNS RICH

MEMORANDUM

February 26, 1985

TO: R. A. BLOTT

cc: L. W. Butler
H. C. Kerr
D. J. Dant

FROM: [Crossed Out]

SUBJECT: *GENERIC VERSUS FULL REVENUE PRICING COMPARISONS*

Since January, 1980, full revenue kings product has increased from a list price of \$23.75 to \$31.15 per M; that is an increase of 31.4%. During the same time-frame, generic prices increased from \$14.95 per M to \$18.75 per M, an increase of 25.4%

The attached analysis compares what has happened to retail carton and pack prices over that period of time. As you will note, this analysis uses average state taxes and standardized wholesaler and retailer markups.

Consequently, you should use the attached for directional advice only as the results will vary greatly depending on state taxes and customer markup policies. In general, however, the retail spread between generics and full revenue pricing has grown significantly over this period of time.

D. P. C.

/th
attachment

KING SIZE PRICING COMPARISON
Generics vs. Full Revenue

	<u>JANUARY 1980</u>		<u>JANUARY 1981</u>		<u>JANUARY 1982</u>		<u>JANUARY 1983</u>		<u>JANUARY 1984</u>		<u>JANUARY 1985</u>	
	<u>GENERIC</u>	<u>FULL REVENUE</u>	<u>GENERIC</u>	<u>FULL REVENUE</u>	<u>GENERIC</u>	<u>FULL REVENUE</u>	<u>GENERIC</u>	<u>FULL REVENUE</u>	<u>GENERIC</u>	<u>FULL REVENUE</u>	<u>GENERIC</u>	<u>FULL REVENUE</u>
List Price Per M	\$14.95	\$23.75	\$16.40	\$25.20	\$16.40	\$26.05	\$17.25	\$26.90	\$17.25	\$29.15	\$18.75	\$31.15
List Price Per Carton	\$ 2.99	\$ 4.75	\$ 3.28	\$ 5.04	\$ 3.28	\$ 5.21	\$ 3.45	\$ 5.38	\$ 3.45	\$ 5.83	\$ 3.75	\$ 6.23
Add Avg. State Tax	\$ 1.10	\$ 1.10	\$ 1.12	\$ 1.12	\$ 1.14	\$ 1.14	\$ 1.16	\$ 1.16	\$ 1.18	\$ 1.18	\$ 1.20	\$ 1.20
	\$ 4.09	\$ 5.85	\$ 4.40	\$ 6.16	\$ 4.42	\$ 6.35	\$ 4.61	\$ 6.54	\$ 4.63	\$ 7.01	\$ 4.95	\$ 7.43
Add 7% Wholesaler Markup	+ .29	+ .41	+ .31	+ .43	+ .31	+ .44	+ .32	+ .46	+ .32	+ .49	+ .35	+ .52
COST TO RETAILER	\$ 4.38	\$ 6.26	\$ 4.71	\$ 6.59	\$ 4.73	\$ 6.79	\$ 4.93	\$ 7.00	\$ 4.95	\$ 7.50	\$ 5.30	\$ 7.95
Add Retail Markup at 11%	+ .48	+ .69	+ .52	+ .72	+ .52	+ .75	+ .54	+ .77	+ .54	+ .83	+ .58	+ .87
CONSUMER COST PER CTN.	\$ 4.86	\$ 6.95	\$ 5.23	\$ 7.11	\$ 5.25	\$ 7.54	\$ 5.47	\$ 7.77	\$ 5.49	\$ 8.33	\$ 5.88	\$ 8.82
Difference Per Carton		\$2.09		\$1.88		\$2.29		\$2.30		\$2.84		\$2.94
As A % of Full Revenue		(30.1%)		(26.4%)		(30.4%)		(29.6%)		(34.1%)		(33.3%)
Estimated Cost Per Pack At 25%	\$.55	\$.78	\$.59	\$.82	\$.59	\$.85	\$.62	\$.88	\$.62	\$.94	\$.66	\$.99
Difference Per Pack		\$.23		\$.23		\$.26		\$.26		\$.32		\$.33
As A % of Full Revenue		(29.5%)		(28.0%)		(30.6%)		(29.5%)		(34.0%)		(33.3%)

BATUS[LOGO]

A MEMBER OF THE BAT INDUSTRIES GROUP

BATUS INC. • 2000 Citizens Plaza •

Louisville, Kentucky 40202 • (502)581-8000

HENRY F. FRIGON

President

March 5, 1985

Dr. I. W. Hughes
Brown & Williamson Tobacco
1500 B&W Tower
Louisville Galleria
Louisville, KY 40202

Dear Wally:

As you know, Charlie McCarty and I went to London the end of January to review the BATUS 5 Year Plan and Budget with the CPC. We have recently received BAT's comments on the discussions at that meeting, and I am enclosing the comments which are relevant to BATUS Corporate and to your operating group.

I do not think you will find anything particularly surprising but I did think you would be interested to see the type of discussions that take place.

Sincerely,

/s/ Hank

Henry F. Frigon

HFF:sr

cc: Mr. John Alar

Mr. T. E. Sandefur

Enclosure

* * *

Tobacco (Cont.)

8. It was agreed that the price of generics should be increased as soon as possible. B&W should be prepared to take the lead on this, while still retaining flexibility to discount the new prices if it became necessary to do so. A key condition for continuing to market generics was that B&W should be in a position to establish price leadership.

REDACTED

MEMORANDUM

To: T. E. Sandefur, Jr.
 CC: J. Alar
 W. L. DeWitt
 I. W. Hughes
 C. J. Heger
 B. M. Lowdenback
 FROM: R. A. Blott
 DATE: March 6, 1985
 SUBJECT: Response to CPC Comments

REDACTED

REDACTED

* * *

8. It was agreed that the price of generics should be increased as soon as possible. B&W should be prepared to take the lead on this, while still retaining flexibility to discount the new prices if it became necessary to do so. A key condition for continuing to market generics was that B&W should be in a position to establish price leadership.

Response:

Brown & Williamson agrees with the C.P.C. viewpoint and would like to initiate a price increase as soon as we possibly can. The key element in leading the price increase, in B&W's judgment, is market strength. We believe that we will achieve that strength when we are confident that we are tracking toward the 8.6 billion target. Brown & Williamson should be in a leadership position from that point forward.

REDACTED

LIMITED

May be opened and seen
by addressee only

MEMORANDUM

To: ALL VICE PRESIDENTS
CC: J. Alar
FROM: T.E. Sandefur, Jr.
SUBJECT: *COMPETITIVE STRATEGY REVIEW*
DATE: March 21, 1985

Because of the increasingly competitive nature of the tobacco industry, each of you, working with your staff, is required to:

Give consideration to the likely future moves by our competitors and the options open to B&W to either preempt or counteract them.

Direct your response to me in the following format by Friday, March 29.

- B&W's Options/Proposed Direction specify:
 - Strategies
 - General Tactics and Plans
 - Contingency Plans (i.e., including the circumstances under which these would be put into action)
- Comments on our Competitors include:
 - Specific tactics/plans you believe our competitors will follow over the next 12-18 months.
 - Alternative or additional strategic directions(s) [sic] for any of our competitors.

- Any additions, changes and/or comments regarding the competitors; strengths and weaknesses listed.
- For your reference, the attached information summarizes our current assumptions regarding the competition, their likely strategies and some additional "thought starters."

/s/ T.E. Sandefur, Jr.
T.E. Sandefur, Jr.

/eah/0014/E

* * *

II. TOBACCO COMPETITORS: STRENGTHS, WEAKNESSES AND STRATEGIC DIRECTION

R.J. Reynolds

STRENGTHS

- Sheer size
- Strong sales force and merchandising program (e.g., fixtures, promotions activity)
- Balanced brand portfolio - best in the industry
- Strong position in production facilities. RJR will become a lower cost producer than B&W.
- A leader in commitments to R&D and Engineering
- Committed to continued investments to build the business through active new products and strong support of established products
- Greater manufacturing flexibility because of non-union shop
- Product quality - renewed emphasis
 - Physical - excellent
 - Smoking - parity
- A willingness to do the "unconventional"

WEAKNESSES

- All brand families are declining.
- Emotional need to regain #1 position (i.e., at times reacts in a "knee-jerk" fashion)
- Quarterly loading practices for "public" reporting purposes generate significant cost inefficiencies.
- Geographical weakness in major metro areas
- Limited markets and brand portfolio in its International business
- Lack of depth of tobacco experience in senior management
- Biggest volume contributor to generics

STRATEGIC DIRECTION (RJR)

- RJR will aggressively pursue a leadership/grow [sic] position in all segments:
 - Price
 - Packaging
 - Female
 - Sizes
 - Styles
- In price segments, RJR is the most likely competitor to enter the black and white generic segment. They will also compete aggressively in mid-price point segments through either new products or conversion of existing brands.
- At the retail level RJR will fight and spend to maintain their existing dominant position in merchandising.
- RJR has geared up to develop a competitive edge on product development/R&D. They are the most likely competitor to develop a "health" product.

- RJR will be able to lead new product innovations and respond to new product opportunities more rapidly than other smaller competitors due to manufacturing capabilities and flexibilities. They will be the most active competitor in new brand activities.
- RJR has developed expertise and quality in packaging which they will use to gain competitive advantage (i.e., fresher products, potentially using some technology from its other food businesses).
- RJR will continue to maintain a leadership position in the area of special events, promotions, direct marketing, etc. This could be a great advantage if further restrictions are placed on traditional advertising methods.
- RJR will continue to assume a leadership role on public issues such as:
 - "Pride in Tobacco"
 - Tobacco support program
 - Smoking & health controversy
- RJR may well attempt to hold or limit their price increases in order to develop a competitive edge, as they are expected to be able to maintain their profitability through increased efficiencies and lower leaf costs. RJR might well attempt to use the fact that it did not increase prices on its product line when other companies did as a marketing tool. Or, RJR could selectively raise prices on only some of its established brands to provide increased profit generation and still "give the consumer a break."

- Internationally, RJR will:
 - Use pricing to penetrate and protect target markets.
 - Use competitive companies as vehicles to enter target markets (i.e., Argentina, South Africa).
 - Aggressively spend in high potential markets, such as Japan, with little regard for short-term profits.
 - Continue to aggressively push "transit" business
 - Continue centralization of decision making

Philip Morris

STRENGTHS

- Sheer size - both domestically and internationally
- Continued growth momentum in the Marlboro brand combined with its already powerful market leadership position
- PM has strong positions in segments which are growing:
 - Starters and younger adults
 - 100 mm
 - Full flavor (N/M)
 - Female
 - Box
- PM's product quality is:
 - Smoking - highest in industry and perceived by the consumer as excellent
 - Physical - parity

- PM is strong geographically in:
 - Metro areas
 - Northeast
 - West Coast
- PM has strong overall breadth and depth in its brand portfolio.
- PM has maintained consistency of marketing focus. Its Leo Burnett agency has excellent marketing/creative talents and strong tobacco experience. . . . "best in the industry".
- PM has concentrated on product technology (R&D, etc.) and production facilities. PM has made long-term financial investments/commitments to support these efforts.
- PM has the best efficiency in marketing spending.
- PM's large sales force represents a competitive advantage over those of smaller competitors.
- PM is on the leading edge of equipment acquisition and development.
- PM has aggressive, risk-oriented decision makers/takers.
- PM has the strongest and most profitable international business.

WEAKNESSES

- PM lacks menthol segment penetration and has no solo menthol brand.
- PM's field sales programs' execution and management skills are below average.
- PM has historically been slow to react to or engage in aggressive pricing.

STRATEGIC DIRECTION (PM)

- PM will aggressively attempt to penetrate the menthol segment. Its primary target appears to be KOOL.
- PM will not take a leadership position in low margin brand marketing.
- PM will make strong attempts to improve its position on shelving at the retail level.
- PM will further line extend existing products where possible (e.g., Marlboro Box 25's, B&H Box 25's, etc.).
- PM will maintain superiority on product smoking quality and improve the physical quality of its products. It is felt that PM will continue to generally follow product innovation rather than become the leader. However, PM will continue to maintain a leading position on smoking quality and work for technical breakthroughs to improve physical quality of products.
- PM will maintain a leading edge position on equipment through development/acquisition and will continue to spend to increase production efficiencies.
- PM will be the leader in image and pricing terms in the up market segments.
- Internationally, PM will intensify investments, especially in third world countries, with the objective of becoming the #1 cigarette company in the world. They are also expected to be actively pursuing new/growing opportunities in China and Eastern Europe. To expand its International business, PM is expected to continue to push its brands in even small markets without showing

profitable returns for a relatively long time in an effort to achieve its longer-term goals.

- PM will continue to maintain a leadership position in terms of its field sales force size and is expected to attempt to upgrade its field programs, execution and skill levels in the future.

Lorillard

STRENGTHS

- One growing trademark - Newport
- Product quality:
 - Physical - above average
 - Smoking - parity
- Regional marketing strength and potentially some special "know-how"
- Willingness to make heavy investments/market spending in target markets
- Size of field force versus share
- Willingness to spend more for maintenance and quality within the manufacturing facilities at the "floor level".

WEAKNESSES

- Declining total market share and declining brand portfolio except Newport
- Lorillard's smoking quality of non-menthol brands is below average.
- Lorillard has had little recent product/new brand development success.
- Lorillard's primary stockholders are unwilling to allocate capital for new equipment or facilities.
- Inconsistency in brand communications

STRATEGIC DIRECTION

- Lorillard will drive Newport. They could become much more aggressive with this brand.
- Lorillard's new management could well be more aggressive and are expected to "try something" on the heels of the Newport's [sic] success. Other possibilities (excluding Newport) could be another female entry, a full flavor or a 100mm brand.
- Lorillard will continue to aggressively spend on media and field activities (i.e., above relative share).
- Lorillard is unlikely to enter the generic business.
- Lorillard will respond to the 25's full margin segment (i.e., possibly Newport 25's which would build starters).
- Lorillard's staff is so lean that future tobacco experience and succession appear in jeopardy.

*American**STRENGTHS*

- Consistent strategy and maximization of cash flow
- Loyal franchise

WEAKNESSES

- A continued "milking" strategy produces a low level of spending in tobacco and insures continued market share and volume erosion of established brands.
- American's brand portfolio is weak and shows lack of growth potential.

- American shows a low level of new brand development and has had a lack of success with their recent attempts (i.e., Lucky).

STRATEGIC DIRECTION

- American is expected to follow basically the existing strategy for their current product line.
- American will selectively spend on brand-line extensions and new product opportunities that require small investments.
- American could provide contract manufacture for:
 - L&M
 - Coremark
 - Other private labels
- American will hold capital spending at a minimum level.
- American shows possible interest in selective international markets (Japan, etc.) for trademark development (i.e., Tareyton).
- American is felt unlikely to enter the black and white generic business.

*L&M**STRENGTHS*

- Leadership position in the economy segment (i.e., defended generic business to date and have the only mid-price product of the major competitors)
- Off-shore leaf facility

WEAKNESSES

- L&M's factory has older and slower speed equipment which is offset somewhat by slightly lower labor costs.

- L&M has poor quality of market share and a weak established brand portfolio.
- L&M's field sales force size is the smallest by a significant number.
- L&M has few R&D and product development facilities and human resources.
- L&M has limited cash/resource availability.

STRATEGIC DIRECTION

- L&M will try to survive by:
 - Raising prices on generics
 - "Sharing" the generic segment with B&W
 - Other niche marketing
 - Mid-price products
 - Ethnic products
 - Grand Met will continue to try to sell L&M
-

LIGGETT & MYERS TOBACCO COMPANY, INC.
One North Park E., Suite 128, Dallas, TX 75231
(214) 369-7191

B. F. Ruggiero
Central Region Manager

DATE: April 2, 1985

TO: Leonard Browning
Bob Daugherty
Bob Dear

FROM: Bart Ruggiero

SUBJECT: Direct Account Business Presentations

I am forwarding a copy of an excellent presentation package put together by Jim Roe and his Managers comparing our Partnership in Profits Program with B&W's offers.

As you all know, B&W people have been hitting the trade quite heavy and distorting the truth with their presentations by indicating that they, the trade, will benefit greatly by changing from our generic product to theirs.

If the trade is not aware of our total program, including all incentives, rebates, promotions, etc., they can easily be mislead into believing that B&W has a solid program which is better than ours. Jim and his people have put together specific information for each of their accounts by using the attached guidelines. They have had success in reversing decisions made by the trade to go with B&W by using these business presentations.

Keep in mind that the attached is an example of how we can influence business decisions when we make the accounts knowledgeable and aware of our programs, which become more meaningful when can see documentation and comparisons.

We commend Jim and his people for developing an outstanding business presentation, which is the possible solution to combating B&W's thrust with direct accounts.

I would suggest you review the attached and develop a similar format for presentation where you feel it will be beneficial. If you have any questi [sic] please let me know.

BFR/mhw

cc: Dave Jackson
Mike Osborn
Jim Roe

MEMORANDUM

TO: J. ALAR
T. E. SANDEFUR
R. A. BLOTT
W. L. DeWITT
C. J. HEGER
B. M. LOWDENBACK

cc: B. E. Bacon
J. K. Wells

FROM: T. A. OLGES

SUBJECT: CAC IX

DATE: APRIL 9, 1985

For your reference, attached are the speech and support material compiled for Mr. McCarty's use at the CAC meeting.

/s/ Trina
T. A. Olges

/mjs/2791J

CAC IX
PHOENIX

BROWN & WILLIAMSON TOBACCO CORPORATION

APRIL 29 - MAY 2, 1985
* * *

TOBACCO BUSINESS: KEY ISSUES (SPEECH - H)

REDACTED

Because of the anticipation that the sunset provision will not operate and because tobacco will remain a target for revenue increases by all levels of government, B&W must further anticipate operating in price tiering is likely [sic].

In response to this issue, B&W established the following competitive pricing strategies to maintain and grow its volume without sacrificing profitability.

-

- B&W's entry and pricing policies within the generic and private label segment will attempt to maximize the profit opportunity available from this market segment. B&W's goal is to improve profits from this segment through a combination of significant production cost reductions and price increases. B&W would hope to reduce the spread between generics and full price productions if it could do so without reducing its share of this segment. B&W's presence within the segment appears to have resulted in reduced consumer advertising by L&M and a slowing in the segment's growth rate.

A major blend change on generics currently in progress will reduce costs by 95¢/1000 cigarettes. These measures will be coupled with Marketing's efforts to further develop more unique identity and equity characteristics in Brown & Williamson's black and white generic product line.

6: INTERMEDIATE PAGES REDACTED

CAC IX - PHOENIX
Brown & Williamson Tobacco Division
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Competitive Pricing Strategy

B&W's competitive pricing strategies to maintain and grow its volume without sacrificing profitability are summarized by the following key directions:

REDACTED

-

- B&W's entry and pricing policies within the generic and private label segment will attempt to maximize the profit opportunity available from this market segment. B&W's goal is to improve profits from this segment through a combination of significant production cost reductions and price increases. B&W would hope to reduce the spread between generics and full price productions if it could do so without reducing its share of this segment. B&W's presence within the segment appears to have resulted in reduced consumer advertising by L&M and a slowing in the segment's growth rate.

-

-

REDACTED

April 15, 1985

LIMITED EXECUTIVE SUMMARY LIGGETT ACQUISITION

A preliminary acquisition study of Liggett & Myers' cigarette business, including the Brazilian leaf processing business has been completed. The scope of the study included consideration of purchase price, earnings potential, asset valuation, working capital requirements, and synergistic savings. Ten scenarios were developed to recognize sensitivities [sic] relating to purchase price, generic volume, and branded volume. Considering the present condition of the business, the earnings potential, and the worth of the assets, it appears most likely that Liggett & Myers' business can be purchased for a price which will yield a high return.

Business Conditions

In early 1984, Grand Metropolitan announced negotiations were taking place for sale of the Liggett & Myers business to its management and some outsiders for \$325 million, consisting of an undisclosed amount of cash and the assumption of certain debt. The sale was not carried out presumably from lack of available financing resulting from competition in the low cost cigarette segment. According to the 1984 Grand Metropolitan report, Liggett's operating income amounted to \$77.9 million during the twelve months ended September 30, 1984. The report went on to state that profits have since been reduced to nominal amounts because of price incentives associated

with generic products which have been extended until June, 1985.

In 1984, Liggett sold 33.5 billion cigarettes or 5.7% of the total market. Their generic sales amounted to 23.9 billion units.

Recently, Grand Metropolitan announced [sic] its intention of selling its Pinkerton Tobacco business for an undisclosed sum.

Based upon the present business conditions, it appears that Grand Metropolitan would like to divest all its tobacco related operations. In fact, the purchase of Pinkerton (which was not studied) may be a condition for the purchase of Liggett.

Purchase Price

According to Grand Metropolitan's Form 10K for the twelve months ended September 30, 1983, Liggett's assets had a book value of \$265 million. It is estimated this amount will increase \$21 million to \$286 million by January 1, 1986. Considering the asset values, the previous sale offering, and the condition of the business, time adjusted rate of return analyses were developed using purchase prices ranging from \$225 million to \$500 million.

LIMITED
May be opened and seen
by addressee only.

MEMORANDUM

[Handwritten]
file

TO: Mr. C. I. McCarty
Mr. H. F. Frigon

FROM: Mr. T. E. Sandefur, Jr.

DATE: April 19, 1985

RE: RICHLAND 250's National Launch and Proposed Generic Pricing Strategy

Per your request, attached is Brown & Williamson's rationale for the national launch of RICHLAND 250's and the Proposed Generic Pricing Strategy as discussed in New Orleans.

Should you need additional information, please let me know.

/s/ T. E. Sandefur, Jr.
T. E. Sandefur, Jr.

/eah

Att.

* * *

GENERIC

B&W's pricing strategy has been to take the leadership in announcing a price increase in 1985 provided we were tracking to the 8.6 billion unit volume objective for 1985.

As we are running behind our volume objectives, we are not in a position to lead a price increase and have, therefore, reassessed our pricing strategy.

It is our current belief that L&M, because of margin erosion will initiate a price increase on the order of \$1.50 per M around mid-year, 1985. To generate volume and improve our market presence, our position is to hold off taking a price increase for three months from the time L&M announces. Having improved our market presence during these three months, we would initiate a price increase of \$2.50 per M. We further anticipate that L&M, again because of margin erosion, would immediately increase their prices to parity with B&W. While such a strategy will negatively impact Trading Profit during the intervening three months, the additional volume generated and the higher level price increase will more than offset this negative impact in 1985.

The attached financial schedule indicates that successful implementation of this strategy, coupled with the benefits of the "low cost blend", will generate a positive 1985 Trading Profit of \$9.6 million, \$6.7 million more than budgeted. Preliminary calculations further indicate that 1986 Generic Trading Profit would increase significantly over the \$14.0 million included in the Plan, on the order of a 100% improvement.

B&W's long-term strategies in Generics continue to be focused on margin improvement and to establish franchise equity through package design, etc.

4/19/85

[LOGO] Liggett & Myers Tobacco Company, Inc.
P.O. Box 60067, Sacramento, California 95860

June 21, 1985

Ted Winterhalder
Division Sales Manager

TO: All Sacramento S/Rs
FROM: T. Winterhalder
SUBJECT: *Price Increase*

As you know we raised our price on Branded & Generics/private label cigarettes. Branded by 20¢ per ctn. & Gneric [sic]/private label King 20¢ & 100's 25¢. This now makes the price uniform on the King & 100's by 20¢ & 25¢ respectively.

As of this date, Doral & B&W Generics have not indicated a price increase. We were forced to raise Generics simply because we are losing money which doesn't make good business sense. If our competitors want to lose money and/or lower the tobacco quality to gain SOM, that is fine but we do not have to. The 20¢ & 25¢ per ctn, is minor to the consumer but major to L&M. I have talked to three main jobbers in Reno, Nevada, & they think we are smart by raising the price on Generics. They all realize throught [sic] our debate programs we are making very little money if any. I also discussed in detail with each Direct Customer that it would make good sense not to have so many prices & recommended that they increase Doral & B&W if carried, with the same selling price as Gary Generics. As we discussed, if you do not take the price increase, the retailer will as they want to hold down the pricing categories due to clerk's & customer's confusion. My presentation made good business sense and all three

jobbers are now selling Doral & Generics for the same price. For your information, Glaser Bros. has a new private label brand called Major made by B&W. It is being sold to Glaser Bros. at the regular B&W Generic price, however, Glaser Bros. is selling Major for the same price as Best Buy, sold by Gary Tobacco.

You can see from the above we have taken a very positive position rather than a negative position. We are the inventors & leaders of Generic/private label cigarettes & have every intention of continued growth & SOM. Bottom line, B&W should not take away any Direct Customers from us as the jobbers are making the same profit whether it be Gary or B&W. Actually, the jobber would be losing money because he would be selling Doral & B&W Generic if carrying for the same price. By carrying Gary brand, he could then justify the Doral/B&W increase & make that extra profit rather than the retailer. As you can see, we have a good sound [sic] sales presentation & at the same time we can put Doral/B&W in a negative position.

B&W entered the Generic business because of our fast 6 to 9% SOM. They felt they had to cut prices in order to compete. All they did was make the low profit Generic segment non profitable. The Gary Generic concept is simple, quality tobacco, lower price & volume. But B&W wanted to give away all the profit to break open the market that we had 100% of. Their price cutting did not work as many warehouses in the United States still have B&W Generics that are 6 months & older. For your information, & all Direct Accounts, Gary Tobacco Co. is working on new merchandising programs to increase sales. We will advise you & our Direct Customers in 2 weeks.. So

advise all your Direct Accounts not to make any changes if they are contemplating one until they hear from you.

Branded prices increase

\$1.00 per M = 20¢ per ctn. (King & 100's)

Gary Tobacco price increase

\$1.00 per M = 20¢ per ctn. King Size

\$1.25 per M = 25¢ per ctn. 100's

By Gary raising the 100's to \$1.25 per M, there will be a uniform difference of 25¢ on all 100's.

cc: W.T. Lewis, File Copy

BATUS [LOGO] A MEMBER OF THE BAT INDUSTRIES GROUP

BATUS INC. • 2000 Citizens Plaza •
Louisville, Kentucky 40202 • (502) 581-8000

HENRY F. FRIGON
President
Chief Executive Officer

SECRET

July 18, 1985

Mr. G. L. Dennis
B.A.T. Industries, p.l.c.
P. O. Box 345 Windsor House
50 Victoria Street
London SW1H 0NL
England

Dear Gerald:

In my absence earlier this week I understand you called and requested a note covering the details of the GPC contract (including the \$20 million guarantee). I believe that all of the following information has been covered verbally with you and Eric Bruell in previous discussions, but we are happy to summarize this complex relationship and opportunity for you.

The trademark license with GPC offers a unique opportunity to deal with the two major concerns about B&W's generic business – the issue of equity in the product, and profitability. While there is very little equity in B&W's current black & white products, GPC accounts for almost one third of the generic market and represents significant equity. Sales of GPC cigarettes for the twelve months ended May 31, 1985, totalled 8.5 billion units, or 27% of that market. These GPC products are presently produced by Liggett and Myers.

Over the next 12 to 18 months B&W will gradually transfer a portion of its present black & white products to the GPC name, to bring about a dramatic reduction in the number of different labels which are produced – from about 40 in 1985 to only 8 by 1987. This will both build our equity in the GPC trademark and enhance manufacturing efficiencies.

With the addition of the 8.5 billion volume of GPC, B&W will be producing 2 share points or more under a single trademark. As the generic volume becomes this large it will be manufactured in long production runs at significant savings, achieving the same economic benefit as domestic manufacturing realizes versus export production.

The GPC volume will not require any incremental capital spending beyond that already projected in the 5 Year Plan, which is intended to support established brands but will also benefit generics. It will not be necessary to expand Macon capacity to accommodate the GPC volume.

The GPC organization will continue to be involved as a "broker" for GPC cigarettes and will help B&W sell and market GPC cigarettes to present and future GPC clients and customers. In addition, under the license arrangement GPC is excluded from doing work for any other tobacco company, which means they have to resign brokerage arrangements with Reemtsma for the "West" and "Astor" brands.

All cigarettes will be made to B&W's manufacturing specifications. B&W will have full control over specifications, marketing programs, prices, and terms and conditions of

sale for all GPC tobacco products. The license covers the entire tobacco products "category" and is worldwide. It will be a "category" exclusive to B&W, including any B&W affiliate(s) to whom B&W assigns rights. This flexibility may offer considerable advantages in the possible future use of the GPC trademark with Associate companies.

B&W will pay GPC a royalty of 15¢ per carton, 75¢ per thousand. We believe that this is a reasonable market rate within the Tobacco industry. On the basis of the current sales level of 8.5 billion, the first year payment would be \$6.4 million. B&W has guaranteed a total minimum royalty of \$20 million to be paid at a minimum rate of \$4 million per year for each of the first five years of the contract. All royalties under the agreement are cumulative and once B&W has covered the total minimum guarantee of \$20 million the minimum obligation terminates. Since B&W plans to convert existing generic volume to the GPC trademark, the annual royalty payments will probably exceed \$8 million after the first year, and the minimum commitment will be met within three years.

You also raised the question of accounting treatment. There really is nothing unusual required by the contract unless, of course, for some unanticipated reason generic volumes fall more than $\frac{1}{3}$ from present levels. The royalty will be charged against income as accrued on sales unless it becomes apparent that the minimum annual payment of \$4 million will not be earned in the first five years. In that case, the annual charge to income would be \$4 million.

Under the license agreement with GPC, which is for 35 years, B&W has the right to terminate the agreement at any time on 90 days' notice. However, the \$20 million total minimum royalty must still be paid. This represents the one slight risk inherent in the contract.

If B&W is blocked from selling GPC cigarettes due to any actual or threatened legal or governmental action, the minimum royalty obligation shall be null and void from the outset until GPC resolves the pending matter.

GPC is obligated to prohibit *any* third party from causing a depreciation in value of the trademark until competitive GPC cigarettes disappear from the marketplace. B&W has rights of termination, rights to renegotiation and a right to void the minimum royalty obligation under this situation.

The GPC business provides B&W with considerably enhanced volume opportunities in generics. As we had anticipated, the rate of growth of this segment has slowed since B&W entered the market with generic products. With B&W's sales increased to one third of overall generic priced cigarettes, B&W will be in a much more competitive market position.

When all of these dimensions of the GPC contract are considered, I am sure you will understand our enthusiasm for the opportunity and our view that the risk is very low in comparison to the potential.

If you require further information, please let me know.

With kind regards,

Sincerely,

Henry F. Frigon

HFF:pjv

RICHLAND TRADE PRESS BRIEFING

Tuesday, July 23, 1985

North Casino Room

Marriott's Essex House

160 Central Park South

New York, NY

Order of Presentation

- | | |
|------------|---|
| 10:30 a.m. | All principals meet in the North Casino Room |
| 11:00 | Guests arrive to be greeted by J. S. Helewicz and representatives of Daniel Edelman, Inc. Brief introduction at that time to T. E. Sandefur and L. W. Butler. (Coffee and juice available) |
| 11:15 | JSH to open meeting, guests asked to be seated |
| 11:20 | <p>Welcome</p> <p>B&W's purpose for hosting briefing</p> <ul style="list-style-type: none"> a. Background on industry's rapidly changing environment and new trends b. Greater segmentation in the marketplace c. Richland's unique position against this background |
| 11:25 | JSH to introduce T. E. Sandefur |
| 11:25 | TES remarks (outlined in detail separately) |
| 11:45 | <p>TES to close remarks</p> <p>JSH to acknowledge L. W. Butler</p> <p>JSH to open question and answer period</p> |
| 12:05 p.m. | Break Q&A period, guests asked to move to tables for luncheon |

12:10	Bar opens
12:25	Lunch served
1:00	TES (option JSH) to wrap up by thanking guests for attending (suggest TES, LWB and JSH remain for any last minute questions)
1:30	Clear luncheon room

* * *

REGARDING PRICING, FIVE YEARS AGO A SMOKER PAID ROUGHLY THE SAME PRICE FOR CIGARETTES REGARDLESS OF BRAND. ONE KEY ON THE CASH REGISTER RANG UP ALL CIGARETTE SALES. WITH THE INTRODUCTION OF GENERIC CIGARETTES IN 1980 THIS CHANGED AS RETAILERS REQUIRED A SECOND TOBACCO PRICE TIER. SINCE THEN, ADDITIONAL PRICE TIERS HAVE EVOLVED AND THE BOOK ON CIGARETTE PRICING IS BY NO MEANS CLOSED. AS NEW PRODUCTS ARE OFFERED, THE RETAILER WILL FACE ADDITIONAL PRICING DECISIONS.

5
DEC 31 1992
OFFICE OF THE
No. 92-466

In The
Supreme Court of the United States
October Term, 1992

LIGGETT GROUP INC.,
now named Brooke Group Ltd.,
Petitioner,
vs.

BROWN & WILLIAMSON
TOBACCO CORPORATION,
Respondent.

On Writ Of Certiorari To The
United States Court Of Appeals
For The Fourth Circuit

JOINT APPENDIX
VOLUME II, PAGES 274-547

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Petition For Certiorari Filed September 16, 1992
Certiorari Granted November 16, 1992

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EDITOR'S NOTE

THE FOLLOWING PAGES WERE POOR HARD COPY AT THE TIME OF FILMING. IF AND WHEN A BETTER COPY CAN BE OBTAINED, A NEW FICHE WILL BE ISSUED.

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KEY

In this Joint Appendix, brackets indicate text added by counsel to inform the Court of appropriate notations or other information not appearing on the face of the document itself. Where the date of a document has been derived by reference to its accompanying testimony, the citation (Tr. __:__) to such testimony has been included with the document's date.

[Handwritten Notes]

29 July [1985]

STRATEGIC Planning Session I

8:30 a.m.

I.A./B.L./EEK/L.B./TAO

R.P. T.N.

TES/UP/RAI/U[Illegible]P/C.M.

- 4: copy generics letter to Ranng
 - copy VFM price [Illegible] C.C.
 - write UPM

New Requirement: M.A.P w/ dates for critical activity
 - TRACKING MODE
 more specifics on V.F.M.
 segment participation [Illegible]

Section III:

guide lines p.3: 25% at op. cash flow + \$100mm
 50% RONA
 + T.P. real
 incompatible with investment in new
 products.

SECTION IV: changes since plan
 focus on priorities up front in plan.

Ray: must be clear on level of detail required appears to
 be focus on early years leads to detailed review/
 critique of operating programs.

*creates potential legal vulnerability

TES: start w/ mission statement:

provide consistent/projectable earnings growth for
 B&W.

"Jump" "husbanding funds" / "conserve resources" = milking strategy.

[Illegible]: utilize available resources to develop participation of the "tobacco business."

deliver to [Illegible] cons./proj. earn gro.

how we do that should be up to us.

Ray: pricing [Illegible] emphasis detail ok/required for generics is particular: more detail than else where

New Products focus: need for rapid exploitation of proven concepts

L.B. Pricing is resegmenting market. B&W should participate in each element of recycling mission

RAB: not sure real price tiering will go beyond GENERIC - Full Price. There is no uniform Trade agreement on her price points [Illegible] store price differences exceed INTRA STORE PRICE TIERS.

10:00 CARL

[Illegible] pricing

[Illegible] rate

PRICING: 75¢ Jan/July each year vs. \$1.00 each in '85 reduced 25¢ based on tobacco pricing change. *5.2% price increase vs. 3.9% inflation on [Illegible] agreed.

do we put in higher p.i. (\$1.00) & raise marketing expenses. (Risk taken only 75¢, cut expenses:

RAB: hold price increase differential in reserve to release only if higher price increase is realized.

25¢ differential - \$21 [Illegible]/yr '86

*STAY w/ 75¢ PD

TIS: why not track with category past Liggett
PI: plan for \$1.50/m = 75¢ in Jan
75¢ in July

[Illegible] \$ price differential/reduce % spread.

MEMORANDUM

TO: R. A. Blott

CC: L. W. Butler C. J. Heger
 T. E. Whitehair T. J. Mooring
 T. Olges T. W. Wilson

FROM: B. E. Bacon

DATE: August 15, 1985

SUBJECT: 1986 DOMESTIC MARKETING GUIDELINES

To assist you in the budgeting process for 1986 Domestic Marketing Expenses, attached is a schedule which details the 1986 Preliminary Plan marketing that was included in the recent Executive Committee Strategic Review meetings. Also attached is a recap of the direction given and assumptions made in arriving at the preliminary 1986 marketing numbers based on the assumptions existing at that time.

Subsequently, decisions were made that delayed until 1986 the RICHLAND 100's introduction and reduced targeted 1986 Domestic Marketing expenditures by \$25 million.

In summary, the targeted 1986 Domestic Marketing expenditures of \$484 million are some \$44 million less than the 1986 amounts included in the 1985 Plan and \$27 million less than the amount included in the 1985 original Budget.

As relates to the review meetings scheduled for August 27 and 28, Marketing management should limit their

proposed spending numbers to no more than the aggregate amount of \$484 million. The specific guidelines, within these constraints, resides with you.

Please advise if you need any additional information.

/s/ B. E. B.

B. E. B.

/af

Attachments

[on this page handwritten
notes indicated in italics]

* * *

These plans are based on anticipated segment pricing.

<u>Pricing (M's)</u>		<u>1986</u>		<u>1987</u>	<u>Average For The Year</u> <u>1988</u>		<u>1989</u>		<u>1990</u>
Full Margin		\$32.54		\$33.98	\$35.42		\$36.87		\$38.32
RICHLAND	2*.55	24.64	25.59	25.69	2*.** 26.77	2*.*3	27.83	28.**	28.91
Generics		21.05	**.*2	22.54	23.99		25.46		26.93
% Difference		24%		24%	24%		25%		25%
RICHLAND/Full Margin									
% Difference		35%		34%	32%		29%		30%
Generics/Full Margin									

The existence of a 30-35% gap between generics and full margin presents an opportunity for an additional, middle price point 15-20% below full revenue. This gap should be filled with branded mid-price products that can capture a significant portion of outflows from full revenue brands and offer, along with generics and branded generics, an economically acceptable alternative to quitting.

Specific plans include:

Generics

1. Manage segment growth and profitability by gradually reducing percent difference between generic and full revenue brands.
2. Enhance and develop GPC trademark to increase consumer brand loyalty and therefore:
 - a. Reduce vulnerability to competitive generics' pricing and promotion.
 - b. Provide a recognized and respected origin for a GPC mid-priced line extension.

<u>Variable Margin (net)</u>	<u>1986</u>	<u>1987</u>	<u>Average For The Year</u> <u>1988</u>	<u>1989</u>	<u>1990</u>
Full Margin	18.12	19.30	20.45	21.57	22.69
RICHLAND	9.09	9.9*	10.63	11.42	12.20
Generics	7.43	8.65	9.83	11.02	12.18

[*=Illegible]

8/16/85

These plans are based on anticipated segment pricing.

*Plan input

[on this page handwritten notes indicated in italics]

8/16/85 *Received from [Illegible]

				<u>Average For The Year</u>					
<u>1985</u>	<u>Pricing (M's)</u>		<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>		
30.93	Full Margin		\$32.54	\$33.98	\$35.42	\$36.87	\$38.32		
23.17	RICHLAND	2*.55	24.64	25.59 25.69	2*. ** 26.77	2*. *3 27.83	28. ** 28.94		
19.42	Generics		21.05	**.*2 22.54	23.99	25.46	26.93		
25%	% Difference RICHLAND/Full Margin		24%	24%	24%	25%	25%		
37%	% Difference Generics/Full Margin		35%	34%	32%	29%	30%		

The existence of a 30-35% gap between generics and full margin presents an opportunity for an additional, middle price point 15-20% below full revenue. This gap should be filled with branded mid-price products that can capture a significant portion of outflows from full revenue brands and offer, along with generics and branded generics, an economically acceptable alternative to quitting.

Specific plans include:

Generics

1. Manage segment growth and profitability by gradually reducing percent difference between generic and full revenue brands.
2. Enhance and develop GPC trademark to increase consumer brand loyalty and therefore:
 - a. Reduce vulnerability to competitive generics' pricing and promotion.
 - b. Provide a recognized and respected origin for a GPC mid-priced line extension.

		<u>Average For The Year</u>					
<u>1985</u>	<u>Variable Margin (net)</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	
.62	Full Margin Excluding Leaf Price Adjustments	18.12	19.30	20.45	21.57	22.69	
.89	RICHLAND	9.09	9.9*	10.63	11.42	12.20	
.65	Generics	-7.43	-8.65	-9.83	-11.02	-12.18	
		***	-2.23	***	-3. **	-3. **	
16	Generics (Excluding Rebates) in	4.32	5.32	6.29	7.26	8.20	

[*=Illegible]

not a fair comparison

[LOGO]

B&W

BROWN & WILLIAMSON
TOBACCO CORPORATION

1986 - 1990 CORPORATE PLAN

RESTRICTED

OCTOBER 1985

REVISED JANUARY 198 [Illegible]

* * *

Key Action Plans

LOW-PRICED 20's

B&W's 1986 volume target is 14.1 billion units or 35.6% share of the segment which represents a 64% growth in volume for 1986 versus 1985's volume target of 8.6 billion units or 24.9% share of segment. To achieve this growth and improve segment profitability, plans are to:

- Increase generic prices by \$1.00/1.25/M in November 1985 and January 1986 and by \$1.00 in July 1986. Based on these price increases, and accounting for planned support, B&W anticipates a significant increase in trading profit.
- Build direct account, wholesaler and distributor customer base through a competitive rebate structure.
 - Effective January 1, 1986, introduce a rebate system based on total customer volume.
 - Combined with B&W's Direct Account Incentive Program and strategic use of consumer incentives, this offer is designed to yield the customer and

consumer base required to generate B&W's 14.1 billion unit volume objective within its Trading Profit goal.

- Use consumer incentives to pull target volume through distribution channels and gain additional retail distribution.
- Convert existing B&W customers to the GPC brand to take advantage of GPC's trade and consumer equity.
- Enhance the GPC trademark through label graphic and promotion material enhancement.
- Insure consumer awareness and retail availability through aggressive in-store signage and display.

MID-PRICED 20's

- Develop and start testing a mid-priced 20's product. "GPC Deluxe," first quarter of 1986.
 - Pending successful test results, a projectable test market will follow in the second quarter 1986 to permit a rollout decision.
-

* * *

Pricing Estimates

<u>Pricing (M's)*</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
<u>Segment</u>						
Full Margin	\$30.93	\$32.97	\$34.54	\$36.19	\$37.91	\$39.65
RICHLAND	22.93	24.64	26.08	27.33	28.65	29.96
Low-Priced 20's	19.18	21.56	23.20	24.90	26.69	28.48
% Difference	25%	25%	24%	24%	24%	24%
RICHLAND/Full Margin						
% Difference	38%	35%	33%	31%	30%	28%
Low-Priced 20's/Full Margin						

The existence of a 28-38% gap between low-priced 20's and full margin presents opportunities for additional, middle price points 15-20% below full revenue. This gap could be filled with branded mid-price products that can capture a significant portion of outflows from full revenue brands and offer economically acceptable alternatives to quitting.

Based on above estimated pricing, the following projects potential contribution margins (pre-specific brand advertising).

<u>Variable Margin (M's)*</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
Full Margin	\$16.90	\$19.00	\$20.24	\$21.60	\$23.04	\$24.46
RICHLAND	8.31	9.89	10.77	11.68	12.64	13.60
Low-Priced 20's (incl. rebates)	1.69	4.72	5.80	7.03	8.34	9.66
% Difference	51%	48%	47%	46%	45%	44%
RICHLAND/Full Margin						
% Difference	90%	75%	71%	67%	64%	61%
Low-Priced 20's/Full Margin						

Although popular price branded products produce a higher gross margin rate (i.e., 54-62%), value products provide substantial rates of return over the plan period (e.g., RICHLAND 35-45%, Generics 9-34%) which are greater than those enjoyed in most other industries.

*Pricing and margin estimates are based on B&W brands' projected financial performance over the plan period.

[In Evidence 12/9/85]

DORAL COMPETITIVE ENTRIES

SHORT AND LONG TERM
STRATEGY RECOMMENDATION

* * *

IMPACT ON CONSUMER. . . GENERICS

- INCREASES AWARENESS LEVEL OF PRICE-BRAND CATEGORY
- USERS WILL BE OFFERED A CHOICE
- NON-USERS WILL BE OFFERED A "BRANDED" PACKAGING ALTERNATIVE
- DORAL AND OTHER COMPETITIVE ENTRIES WILL ATTRACT FROM THE POOL OF POTENTIAL GENERIC SMOKERS
- RATE OF NEW TRIAL ON GENERIC COULD DECLINE AS THE NUMBER OF COMPETITIVE ENTRIES INCREASE
- COULD EVENTUALLY LEAD TO INCREASED NEGATIVE QUALITY PERCEPTIONS OF GENERICS DUE TO SIMPLE PACKAGING

* * *

TOTAL NET NET DORAL ADVANTAGE OVER
GENERIC/PRIVATE LABEL

<u>CASES PER QTR</u>	<u>GENERIC BROKER</u>	<u>FRAN- CHISE DIST.</u>	<u>100MM PR. LABEL</u>	<u>50MM PR. LABEL</u>
0-99	-.082	+.018	-.013	-.043
100-199	-.102	-.002	-.033	-.063
200-299	-.152	-.052	-.083	-.113
300-399	-.172	-.072	-.103	-.133
400-499	-.192	-.092	-.123	-.153
500+	-.212	-.082	-.143	-.173*

- DORAL'S ADVANTAGE OVER OUR PRICING AFTER DISCOUNTING TERMS AND ALLOWANCES RANGES
 - FROM 8.2¢ TO 21.2¢ ON OUR BROKER BRANDS
 - FROM 1.8¢ TO 8.2¢ ON FRANCHISED BRANDS
 - FROM 1.3¢ TO 14.3¢ ON 100 MM PRIVATE LABEL BRANDS
 - FROM 4.3¢ TO 14.3¢ ON 50MM PRIVATE LABEL BRANDS
- FOR 50MM PRIVATE LABEL CUSTOMERS RECEIVING 3¢ PER CARTON COMMISSION
- THE RANGE OF DORAL'S ADVANTAGE IS FROM 4.3¢ TO 14.3¢ PER CTN.

* * *

RECOMMENDATION

- ALTERNATIVE VII

RATIONALE

- THIS RECOMMENDATION IS AGGRESSIVE.
- THIS RECOMMENDATION BEATS COMPETITIVE TERMS AND COMPETITIVE ALLOWANCES OF DORAL BRAND FOR ALL BROKER CUSTOMERS.
- WOULD STRENGTHEN OUR LEADERSHIP AND INNOVATIVE STATURE AMONG ALL ACCOUNTS.
- WOULD PUT ALLOWANCES "DIRECTLY INTO THE HANDS" OF ALL ACCOUNTS; PHYSICALLY RECEIVING PAYMENT BY CHECK RECOMMENDED OVER CREDIT MEMOS.

IMPLEMENTATION

- CORPORATE ACCOUNTS CAN BE CONVINCED OF THE EXTREME URGENCY THAT ALL CASH PAYMENTS BE MADE BY US DIRECTLY TO CUSTOMERS AND DIVISIONS BY SHIP POINT ON A QUARTERLY BASIS. IN THIS CASE, LUMP SUM PAYMENTS TO HEADQUARTERS OR A CENTRAL LOCATION WOULD BE TREATED ONLY AS AN EXCEPTION.
- THIS RECOMMENDATION PAVES THE WAY FOR FULL FLAVOR GENERIC AND PRIVATE LABEL CIGARETTES AND FUTURE BRAND EXTENSIONS.

ADDENDUM
POSITION PAPER
CURRENT STATUS OF B&W'S GENERICS

As further information this addendum compares Brown & Williamson's actual performance on GENERICS with our assessment of the performance (sales & Trading Profit) of DORAL over the same period (July, 1984 - December, 1985). It should be noted that DORAL was converted to GENERIC pricing in the spring of 1984.

In summary, comparative performance is calculated as follows:

	(Quantities In Billions, Dollars in Millions)					
	July-Dec. 1984		1985		TOTAL	
	B&W* GENERICS	DORAL	B&W* GENERICS	DORAL	B&W* GENERICS	DORAL
Volumes	2.2	1.8	7.9	6.8	10.1	8.6
Variable Margin - After Mfg. Overheads	\$9.6	\$8.0	\$40.3	\$31.0	\$49.9	\$39.0
Rebates, Adv., Stickering, Fixtures, Selling, Etc.	10.0	7.6	41.9	36.2(a)	51.9	43.8
Trading Profit Loss	\$<.4>	\$.4	\$<1.6>	\$<5.2>	\$<2.0>	\$<4.8>

288

* Brown & Williamson GENERICS

(a) We estimate \$20.3 for \$1 off stickering, \$6.0 second half advertising, \$6.2 rebates and \$3.7 for fixtures.

[Handwritten Notes]

(B)

(C) See Attached [Handwritten Notes End]

The 1985 exit share (October - December) for the total of B&W's GENERIC volumes is approximately 2.0% (50/50 GPC - Black & White/Private Label) versus DORAL's exit share of approximately 1.5%.

B. E. B.

1/8/86

See attached [Handwritten Note]

* * *

[Handwritten Notes]

10,900,000

905,500

X

(B) We estimate that the heavy spending will continue into 1986. The annualized costs for 1986 therefore would be as follows: \$48 million for stickering @ \$1.00 off, \$9 million for advertising, \$9.7 million for rebates, \$6 million for fixtures

(C) Information provided from wholesale accounts has shown us that Black and White product will outsell Doral by a 4 to 1 ratio when Doral product is not stickered.

FURMAN SELZ MINGER DIETZ & BIRNEY

Telex

Incorporated

Telephone

Cable

230 Park Avenue

Trading

[Illegible]

New York 10169

[Illegible]

Industry Comment

The Maxwell Report

Revised 1985 Year-end
Sales Estimates for the
Cigarette Industry

John C. Maxwell, Jr.
(212) 309-8468

February 3, 1986

[Illegible]

* * *

1985 YEAR END INDUSTRY OVERVIEW

In the face of considerable uncertainty, the cigarette industry ended the year on a strong note. Shipments were 595 billion units, a decline of only 0.8% versus the 600 billion in 1984. In the final months of 1985 cigarette sales were erratic due to swings in trade inventories related to the possible sunseting of the \$0.16 per pack Federal Excise Tax. This tax, which had been levied as of January 1983, was scheduled to fall back to the previous \$0.08 level on October 1, 1985. However, the higher tax rate was extended by Congress several times during the last months of 1985 with the latest extension being to March 15, 1986. We believe the \$0.16 tax will be maintained. At the end of December, the Industry instituted a price increase. The counterbalancing effect of these two events meant high trade inventory accumulation.

Looking at the industry's dynamics, while the adult population has been growing slightly above 1% annually, smoking incidence and consumption per day continue to decrease marginally. The overall impact is a reduction in consumer sales. Retail consumer sales were down about 1% from last year's level, and this rate of decline is expected to continue in the near term.

The foremost marketplace development of 1985 and the past several years has been the expansion of the price value category. It is composed of: all the generic priced entries, including, "no frills" and score brands from Liggett and Brown & Williamson, and brands such as Reynolds' Doral; the mid-priced brands, e.g. Liggett's Stride, and the value priced 25's - Reynolds' Century, B&W's Richland, and Philip Morris' Players Lights 25's, Century is just going to 10 packs per carton rather than 9 at the same price, in line with the Richland price structure. For the full year, the collection of price value brands had a share increase from 5.5% to 7.3%.

ANALYSIS OF COMPANY SHARE BY PRICE SEGMENT

	<u>Full Priced</u>	<u>Price Value</u>	<u>Total Market</u>
Philip Morris	38.5	2.3	35.9
R.J. Reynolds	32.1	25.9	31.6
Brown & Williamson	10.9	24.3	11.9
Lorillard	8.8	-	8.1
American	8.1	-	7.5
Liggett	1.6	47.5	5.0
Total	100.0	100.0	100.0
Market Share	92.7	7.3	100.0

Among the top selling brands, Marlboro and Newport turned in strong performances. Marlboro, the number one brand, improved its market share to 22.4% up 0.9 share points over last year. It was helped by the national distribution of Marlboro 25's. Likewise, Newport hit a new high of 3.4%, up 12% ahead of last year by 0.4% share points. At current rates it should by pass [sic] Pall Mall for the ninth position this year. Virginia Slims also showed

* * *

BROWN & WILLIAMSON TOBACCO CORP.
FULL-YEAR BRAND SALES AND MARKET SHARES

293

	Sales (Bil. Units)			Market Shares (%)				
	1984	1985	Change	1985	1984	1983	1982	1981
Kool								
85s (16)	22.89	21.44	(6.3)	3.6	3.8	3.9	4.*	4.8
Hard Box (16)	1.99	2.29	15.1	0.4	0.3	0.3	.*	0.3
100s (16)	7.74	7.25	(6.3)	1.2	1.3	1.3	1.4	1.5
Milds (11)	5.10	5.07	(0.6)	0.8	0.9	0.9	0.9	1.0
Milds Longs (12)	0.76	0.88	-	0.1	0.1	0.1	.*	0.1
Super Lights Kings (7)	-	-	-	-	-	-	-	0.3
Super Lights 100s (9)	-	-	-	-	-	-	-	0.3
Light Kings (9)	1.08	1.01	(6.5)	0.2	0.2	0.2	0.4	-
Light 100s (10)	1.02	0.94	-	0.2	0.2	0.2	0.*	-
Ultra Kings (2)	0.63	0.58	-	0.1	0.1	0.1	0.1	-
Ultra 100s (5)	0.71	0.66	-	0.1	0.1	0.1	0.*	-
Total	41.92	40.12	(4.3)	6.7	7.0	7.1	8.2	8.3
Raleigh*								
85s (16)	3.13	2.68	(14.4)	0.5	0.5	0.6	0.7	0.8
100s (16)	2.14	1.86	(13.1)	0.3	0.4	0.4	0.4	0.4
Lights (8)	0.76	0.61	-	0.1	0.1	0.1	0.2	0.2
Lights Longs (8)	0.78	0.63	-	0.1	0.1	0.1	0.2	0.2
Total	6.81	5.78	(15.1)	1.0	1.1	1.2	1.5	1.6
Viceroy								
85s (14)	4.03	3.61	(10.4)	0.5	0.7	0.7	0.9	0.9
100s (16)	1.33	1.17	(12.0)	0.2	0.2	0.2	0.3	0.3
Rich Lights (8)	0.50	0.40	-	0.1	0.1	0.1	0.1	0.2
Rich Lights Longs (9)	0.56	0.43	-	0.1	0.1	0.1	0.1	0.1
Total	6.42	5.61	(12.6)	0.9	1.1	1.1	1.4	1.5
Belair*								
85s (*)	2.45	2.13	(13.1)	0.4	0.4	0.4	0.5	0.6
100s (*)	2.12	1.83	(13.7)	0.3	0.4	0.4	0.5	0.5
Total	4.57	3.96	(13.3)	0.7	0.8	0.8	1.0	1.1
Barclay								
85s (1)	1.99	1.61	(19.1)	0.3	0.3	0.4	0.5	0.5
100s (3)	1.36	1.04	(23.5)	0.2	.*	.*	.*	.*
Box (1)	0.54	0.49	-	0.1	.*	.*	.*	.*
Menthol 85s (1)	0.32	0.26	-	-	.*	.*	.*	.*
Menthol 100s (3)	0.35	0.27	-	-	.*	.*	.*	.*
Total	4.56	3.67	(19.5)	0.6	.*	.*	.*	.*
Richland								
85s (1)	0.31	1.15	-	.*	-	-	-	-
Menthol 85s (3)	0.20	0.24	-	.*	-	-	-	-
Lights 85s (**)	0.01	0.35	-	.*	-	-	-	-
Total	0.52	1.74	-	.*	-	-	-	-
Generics	2.17	7.36	61.3	1.*	.*	-	-	-
All Others	0.37	0.12	-	-	-	.*	-	-
TOTAL FILTER	67.34	69.36	4.2	.*	.*	.*	.*	.*
Raleigh (King (24)	0.57	0.52	-	.*	.*	.*	.*	.*
Kool (Regular) (19)	0.38	0.36	-	0.1	0.*	.*	.*	.*
TOTAL DOMESTIC	67.99	70.74	4.0	11.9	11.*	11.5	.*	14.*
Filter % of B&W Total	98.6%	98.3%	-	98.*%	98.6%	98.*%	.*%	38.6%

[*=Illegible]

LIGGETT GROUP, INC.

ESTIMATED FULL-YEAR BRAND SALES AND MARKET SHARES

	Sales (Bil. Units)			Market Shares (%)			
	1984	1985	Change	1985	1984	1983	1982
Generics							
85s (14)	9.11	7.17	(21.3)%	1.2	1.5	1.2	0.4
100s (14)	9.34	8.16	(12.6)	1.4	1.6	1.1	0.3
Menthol 85s (14)	2.56	2.09	(18.4)	0.4	0.4	0.3	0.1
Menthol 100s (14)	2.90	2.63	(9.3)	0.4	0.5	0.3	0.1
Total	<u>23.91</u>	<u>20.05</u>	<u>(16.1)</u>	<u>3.4</u>	<u>4.0</u>	<u>2.9</u>	<u>0.9</u>
L&M							
85s Soft Pack (14)	2.40	2.09	(12.9)	0.4	0.4	0.5	0.5
85s Hard Pack (14)	0.05	0.04	-	-	-	-	-
100s (14)	0.69	0.59	-	0.1	0.1	0.1	0.2
Lights (8)	0.23	0.16	-	-	-	0.1	0.1
Total	<u>3.37</u>	<u>2.88</u>	<u>(14.5)</u>	<u>0.5</u>	<u>0.5</u>	<u>0.7</u>	<u>0.8</u>
Eve							
Slim Lights (13)	0.31	0.19	-	-	0.1	0.1	0.2
Menthol 100s (13)	0.21	0.12	-	-	-	-	0.1
120s (14)	1.02	1.05	2.9	0.2	0.2	0.1	-
Menthol 120s (14)	0.68	0.69	-	0.1	0.1	0.1	-
Total	<u>2.22</u>	<u>2.05</u>	<u>(7.7)</u>	<u>0.3</u>	<u>0.4</u>	<u>0.3</u>	<u>0.2</u>
Lark							
85s (14)	0.51	0.37	-	0.1	0.1	0.1	0.3
100s (15)	0.26	0.19	-	-	-	0.1	0.1
Lights 85s (13)	0.61	0.58	-	0.1	0.1	0.1	-
Lights 100s (14)	0.42	0.41	-	0.1	0.1	0.1	-
Total	<u>1.80</u>	<u>1.55</u>	<u>(13.9)</u>	<u>0.3</u>	<u>0.3</u>	<u>0.4</u>	<u>0.4</u>
All Others:	0.15	0.87	-	0.1	-	-	0.3
TOTAL FILTER	31.45	27.40	(12.9)	4.6	5.2	4.3	2.4
Chesterfield							
King* (22)	2.14	1.91	(10.7)	0.3	0.4	0.3	0.4
Regular* (17)	0.35	0.30	-	0.1	0.1	0.1	0.1
TOTAL DOMESTIC	33.94	29.61	(12.8)	5.0	5.7	4.7	2.9
Filter % of Lig. Total	92.7%	92.5%		92.5%	92.5%	92.5%	96.5%

*Couponed Cigarettes

*Decade's Sales are Included in All Others.

Includes unsaleable & promotional goods.
Excludes International military sales.

	1984	1985
Total Consumption	600.17	595.14
Total Production	597.80	588.00
Change in Inventory	<u>2.37</u>	<u>7.14</u>
[*=Illegible]		(0.8)%
		(1.6)
		-

BROWN WILLIAMSON
TOBACCO CO
BOX 35090 09 SALES ADMIN.
LOUISVILLE KY 40232

Western Union
Mailgram (SEAL)

4-037345U167033 06/14/86 ICS AT21762 NYAD
02189 MLTN VA 06/16/86 38

MODERN TOB CO INC
7 GRACE CHURCH ST
PORT CHESTER NY 10573

EFFECTIVE WITH SHIPMENTS OF JUNE 23, 1986, THE LIST PRICE OF OUR KING SIZE FILTER AND REGULAR SIZE BRANDS (WITH THE EXCEPTION OF RICHLAND KINGS) IS INCREASED BY \$.25 PER THOUSAND (FROM \$34.15 PER THOUSAND TO \$34.40 PER THOUSAND), AND THE LIST PRICE OF RICHLAND KINGS IS INCREASED BY \$.20 PER THOUSAND. SINCE INVOICE PRICES FOR RICHLAND VARY BY LOCALITY DUE TO STATE AND LOCAL TAX DIFFERENTIAL ADJUSTMENTS, WE ARE SENDING YOU YOUR NEW RICHLAND KINGS PRICE IN A SEPARATE LETTER.

OUR MAILGRAM OF JUNE 12, 1986, STATED THAT AFTER YOU HAVE ORDERED ONE AVERAGE WEEK'S SUPPLY, BY BRAND STYLE, FOR SHIPMENT DURING THE WEEK OF JUNE 16, 1986, YOU MAY PURCHASE AND RECEIVE 200% OF AN AVERAGE WEEK'S SUPPLY, BY BRAND STYLE, DURING THE WEEK OF JUNE 23, 1986, BASED ON THE OLD PRICE. THIS ENTITLEMENT REMAINS IN EFFECT. WE WILL INCLUDE IN THE CREDIT MEMO COVERING THE DIFFERENCE BETWEEN NEW AND OLD PRICE, THE ADDITIONAL \$.25 PER THOUSAND INCREASE (\$.20 FOR RICHLAND KINGS).

GENERIC/GPC/PRIVATE LABEL

EFFECTIVE WITH SHIPMENTS OF JUNE 30, 1986, THE LIST PRICE FOR OUR KING SIZE FILTER GENERIC/GPC/PRIVATE LABEL CIGARETTES IS INCREASED BY \$.25 PER THOUSAND. AS STATED IN OUR JUNE 12, 1986, MAILGRAM, YOU MAY PURCHASE 150% OF AN AVERAGE WEEK'S SUPPLY FOR SHIPMENT EACH OF THE WEEKS OF JUNE 16, 1986, AND JUNE 23, 1986, BASED ON THE CURRENT INVOICE PRICE OF \$19.75 PER THOUSAND FOR KING SIZE FILTER AND \$21.00 PER THOUSAND FOR 100MM AND KING SIZE NON-FILTER STYLES. BEGINNING WITH SHIPMENTS OF JUNE 30, 1986, OUR GENERIC/GPC/PRIVATE LABEL PRICES WILL BE \$21.00 PER THOUSAND FOR KING SIZE FILTER AND \$22.25 PER THOUSAND FOR 100MM AND KING SIZE NON-FILTER STYLES.

THANK YOU FOR YOUR CONTINUED COOPERATION IN THE MARKETING OF OUR PRODUCTS.

BROWN & WILLIAMSON
TOBACCO CORPORATION

20112 EST
MGMCOMP

LIGGETT & MYERS
DURHAM NC 27702 20AM
1-222512U171023 06/20/86 ICS JA16614
22677 MLTN VA 06/23/86 JN 41196

Western Union
Mailgram (SEAL)
RALB

W. S. REGELE
LIGGETT & MYERS TOBACCO CO.,
WEST MAIN & FULLER STREETS
DURHAM, N. C. 27702

RECEIVED
JUN 20 1986
W. S. REGELE

JUNE 20, 1986

TO OUR VALUED CUSTOMERS:

EFFECTIVE WITH SHIPMENTS MADE JUNE 24, 1986 AND THEREAFTER THE LIST PRICE OF OUR BRANDED REGULAR SIZE AND KING SIZE FILTER CIGARETTES WILL BE INCREASED BY TWENTY-FIVE CENTS (\$.25) PER THOUSAND CIGARETTES; FROM \$34.15 PER THOUSAND TO \$34.40 PER THOUSAND, SUBJECT TO OUR REGULAR CREDIT TERMS.

GENERIC AND PRIVATE LABEL CIGARETTES

EFFECTIVE JULY 01, 1986, THE LIST PRICE FOR 100MM STYLES OF GENERIC AND PRIVATE LABEL CIGARETTES MANUFACTURED BY LIGGETT & MYERS TOBACCO COMPANY WILL BE INCREASED ONE DOLLAR TWENTY-FIVE (\$.25) PER THOUSAND CIGARETTES INSTEAD OF ONE DOLLAR FIFTY CENTS (\$.50) PER THOUSAND CIGARETTES FOR 100MM STYLES AS STATED IN OUR MAILGRAM OF JUNE 13, 1986. THE NET EFFECT IS THAT ALL GENERIC/PRIVATE LABEL BRANDS WILL INCREASE \$1.25 PER THOUSAND CIGARETTES EFFECTIVE JULY 1, 1986.

ALL OTHER STATEMENTS MADE IN OUR MAILGRAM
DATED JUNE 13, 1986, REMAIN UNCHANGED.

WE THANK YOU FOR YOUR CONTINUED COOPERA-
TION IN THE MARKETING OF ALL OUR PRODUCTS.

LIGGETT & MYERS TOBACCO COMPANY
DURHAM, NORTH CAROLINA 27702
1719 EST

MGMCOMP MGM

BROWN WILLIAMSON
TOBACCO CO
BOX 35090 SALES COMM (09)
LOUISVILLE KY 40232

Western Union
Mailgram (SEAL)

1-088445U338025 12/04/87 ICS AT21762 LLVC
02139 MLTN VA 12/04/87 JN82538

H T HACKNEY CO
P O BOX 399
SOMERSET KY 42501

TO OUR CUSTOMERS:

EFFECTIVE AT THE CLOSE OF BUSINESS TODAY,
DECEMBER 4, 1987, THE LIST PRICES OF OUR CIGA-
RETTE BRANDS ARE INCREASED AS FOLLOWS:

- FALCON LIGHTS AND RICHLAND 20'S
(WHERE AVAILABLE) - \$2.50 PER THOU-
SAND
- RICHLAND 25'S AND KIM 25'S (WHERE
AVAILABLE) - \$1.60 PER THOUSAND
- GENERICS/GPC/PRIVATE LABEL - \$2.75
PER THOUSAND
- ALL REMAINING BRAND STYLES WITH
THE EXCEPTION OF BARCLAY LIGHTS
ULTRA THINS (WHERE AVAILABLE) -
\$2.00 PER THOUSAND

THE LIST PRICE OF BARCLAY LIGHTS ULTRA THINS,
WHICH IS BEING INTRODUCED IN LIMITED MARKET
AREAS, WILL NOT BE INCREASED AT THIS TIME AND
REMAINS UNCHANGED.

ALL ORDERS RECEIVED AFTER THE CLOSE OF BUSI-
NESS TODAY (INCLUDING STANDING AND FUTURE-

DATED ORDERS FOR SHIPMENT ON TUESDAY, DECEMBER 8, 1987) WILL BE INVOICED AT THE NEW PRICE.

FOR ALL OF OUR CIGARETTE BRANDS, WITH THE EXCEPTION OF OUR GENERIC/GPC/PRIVATE LABEL CIGARETTES AND BARCLAY LIGHTS ULTRA THINS, YOU MAY PURCHASE UP TO A MAXIMUM OF THE FOLLOWING PERCENTAGES OF EACH STYLE BY WEEK AND RECEIVE A CREDIT MEMO FOR THE DIFFERENCE BETWEEN THE OLD AND NEW PRICE (LESS NORMAL DISCOUNTS):

1. ORDERS RECEIVED AFTER THE CLOSE OF BUSINESS FRIDAY, DECEMBER 4, 1987, FOR SHIPMENT BETWEEN TUESDAY, DECEMBER 8, AND FRIDAY, DECEMBER 11, 1987:

250%

THE ABOVE ORDERS MUST BE RECEIVED IN OUR ORDER

Received Dec 09 1987

MAILGRAM SERVICE CENTER
MIDDLETOWN, VA, 22645
08PM

Western Union
Mailgram (SEAL)

1-239212U342025 12/08/87 ICS WAI6614 RLAC
00586 MLTN VA 12/08/87 JN83277

J. R. DAVIS
LIGGETT & MYERS TOBACCO CO.,
300 NORTH DUKE ST
DURHAM, N. C. 27702

DECEMBER 8, 1987

TO OUR VALUED CUSTOMERS:

BRANDED CIGARETTES

EFFECTIVE WITH SHIPMENTS MADE DECEMBER 10, 1987 AND THEREAFTER, THE LIST PRICE OF ALL OUR BRANDED CIGARETTES WITH THE EXCEPTION OF L&M 30'S ARE INCREASED TWO DOLLARS (\$2.00) PER THOUSAND. BRANDS PREVIOUSLY BILLED AT \$37.15 PER THOUSAND WILL BE BILLED AT \$39.15 PER THOUSAND AND BRANDS PREVIOUSLY BILLED AT \$38.65 PER THOUSAND WILL BE BILLED AT \$40.65 PER THOUSAND. L&M 30'S IN TEST AREA ARE INCREASED ONE DOLLAR SIXTY CENTS (\$1.60) PER THOUSAND.

ALL ORDERS OF BRANDED CIGARETTES INCLUDING L&M 30'S IN TEST AREA RECEIVED IN OUR DURHAM, NORTH CAROLINA OFFICE AT 8:00 A.M. EASTERN STANDARD TIME ON DECEMBER 9, 1987, AND THEREAFTER, AS WELL AS STANDING ORDERS AND ORDERS FOR FUTURE SHIPMENT, WILL BE BILLED AT THE NEW PRICE.

WE WILL ACCEPT AND INVOICE THREE (3) SPECIAL ORDERS FOR BRANDED CIGARETTES INCLUDING L&M 30'S IN THE TEST AREA AT THE OLD PRICE.

THE FIRST ORDER COVERING 150% OF A NORMAL WEEK'S AVERAGE PURCHASES, BY BRAND STYLE MUST BE RECEIVED AT OUR DURHAM, NORTH CAROLINA OFFICE, NO LATER THAN 11:00 A.M., EASTERN STANDARD TIME, THURSDAY, DECEMBER 17, 1987, AND BE FOR SHIPMENT DURING THE PERIOD DECEMBER 14, 1987 THROUGH DECEMBER 18, 1987.

THE SECOND ORDER COVERING 200% OF A NORMAL WEEK'S AVERAGE PURCHASES, BY BRAND STYLE, MUST BE RECEIVED AT OUR DURHAM, NORTH CAROLINA OFFICE, NO LATER THAN 11:00 A.M., EASTERN STANDARD TIME, WEDNESDAY, DECEMBER 23, 1987 AND MUST BE FOR SHIPMENT DURING THE PERIOD DECEMBER 21, 1987 THROUGH DECEMBER 24, 1987.

Received Dec 09 1987.

SAMI/Burke

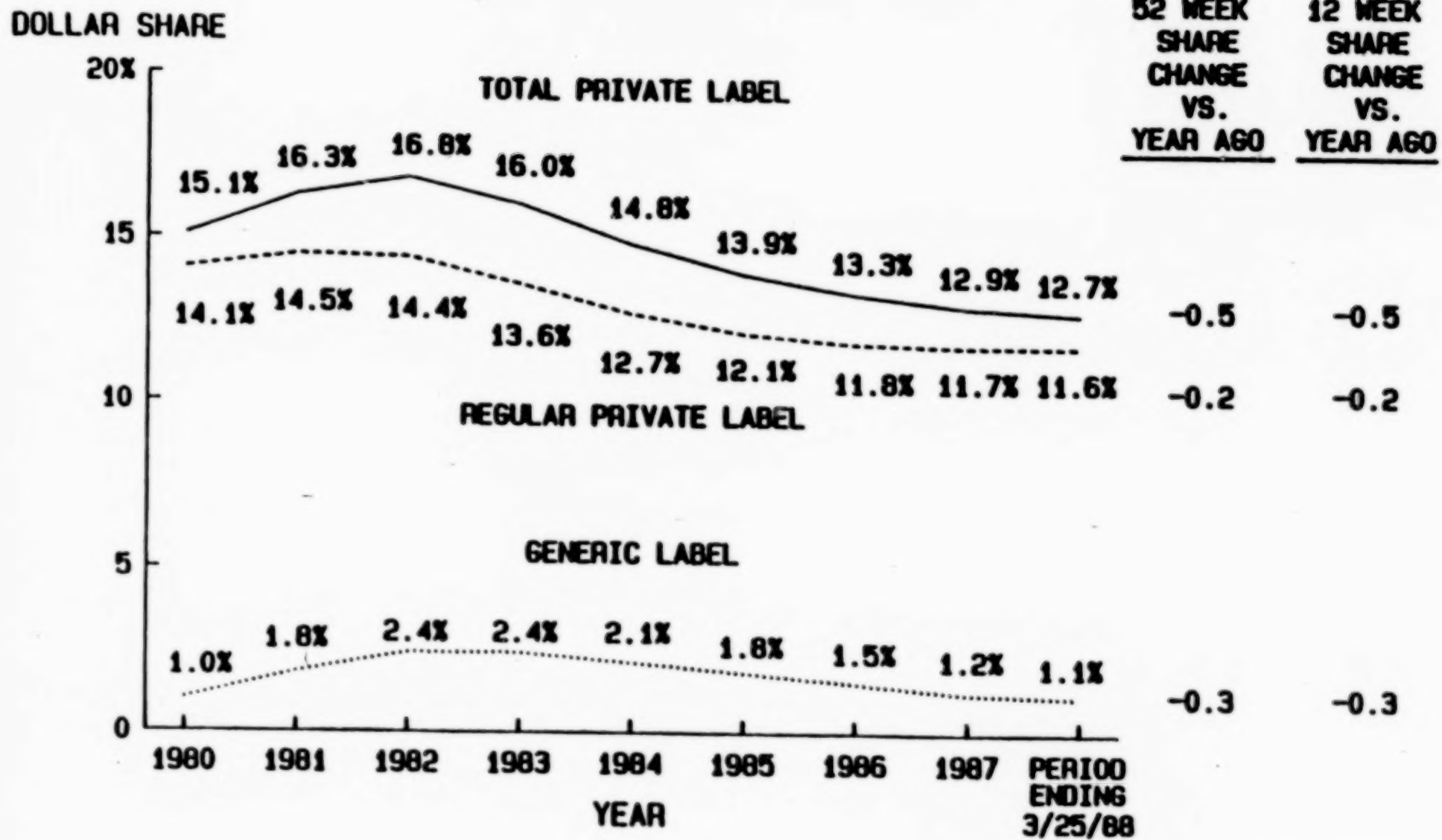
Private Label & Generic Analysis

* * *

MARKETING IN THE 80'S

PRIVATE LABEL & GENERIC DOLLAR SHARES

ALL DEPARTMENTS COMBINED



SAMI/BURKE

BROWN WILLIAMSON
TOBACCO CO
BOX 35090 SALES COMM (09)
LOUISVILLE KY 40232

Western Union
Mailgram

1-155629U168008 06/16/88 ICS AT21762 RLAC
01417 MLTN VA 06/16/88 JN37174

DEAR CUSTOMER:

EFFECTIVE AT THE CLOSE OF BUSINESS TODAY, JUNE 16, 1988, THE LIST PRICES OF OUR CIGARETTE BRANDS ARE INCREASED AS FOLLOWS:

- FALCON LIGHTS, RICHLAND 20'S (WHERE AVAILABLE), AND VICEROY GENERICS (WHERE AVAILABLE) - \$2.50 PER THOUSAND
- RICHLAND 25'S - \$1.60 PER THOUSAND
- GENERICS/GPC/PRIVATE LABEL - \$2.75 PER THOUSAND
- ALL REMAINING BRAND STYLES - \$2.00 PER THOUSAND.

ALL ORDERS RECEIVED AFTER THE CLOSE OF BUSINESS TODAY (INCLUDING STANDING AND FUTURE-DATED ORDERS FOR SHIPMENT ON MONDAY, JUNE 20, 1988) WILL BE INVOICED AT THE NEW PRICE.

FOR ALL OUR CIGARETTE BRANDS WITH THE EXCEPTION OF GPC CIGARETTES, YOU MAY PURCHASE UP TO A MAXIMUM OF 175% OF YOUR AVERAGE WEEKLY PURCHASES DURING EACH OF THE FOLLOWING TIME PERIODS AND RECEIVE A CREDIT MEMO FOR THE DIFFERENCE BETWEEN THE OLD AND NEW PRICE (LESS NORMAL DISCOUNTS). WE

WILL INCLUDE IN THE CREDIT MEMO ALL REASONABLE PURCHASES OF GPC CIGARETTES DURING THESE TWO TIME PERIODS.

- SHIPMENTS BETWEEN MONDAY, JUNE 20, AND FRIDAY, JUNE 24, 1988.

THESE ORDERS MUST BE RECEIVED IN OUR ORDER DEPARTMENT BY 12:00 NOON (YOUR TIME) THURSDAY, JUNE 23, 1988.

LIGGETT & MYERS
TOBACCO CO.
300 N DUKE ST
DURHAM NC 27702 17PM

Western Union
Mailgram

1-219113U169025 06/17/88 ICS WA16614 RLAC
00630 MLTN VA 06/17/88 JN37549

J. R. DAVIS
LIGGETT & MYERS TOBACCO CO.,
300 NORTH DUKE ST
DURHAM, N. C. 27702

TO OUR VALUED CUSTOMERS JUNE 17, 1988

EFFECTIVE JUNE 17, 1988 AND THEREAFTER, THE LIST PRICE OF ALL OUR BRANDED CIGARETTES WITH EXCEPTION OF L&M 30'S WILL BE INCREASED TWO DOLLARS (\$2.00) PER THOUSAND CIGARETTES. BRANDS PREVIOUSLY BILLED AT \$39.15 PER THOUSAND WILL BE BILLED AT \$41.15 PER THOUSAND AND BRANDS PREVIOUSLY BILLED AT \$40.65 PER THOUSAND WILL BE BILLED AT \$42.65 PER THOUSAND, SUBJECT TO OUR REGULAR CREDIT TERMS. L&M 30'S IN THE TEST AREA WILL BE INCREASED ONE DOLLAR THIRTY THREE CENTS (\$1.33) PER THOUSAND.

IN ADDITION, EFFECTIVE JUNE 17, 1988 AND THEREAFTER, THE LIST PRICE OF ALL GENERIC AND PRIVATE LABEL CIGARETTES MANUFACTURED BY LIGGETT & MYERS TOBACCO COMPANY WILL BE INCREASED TWO DOLLARS SEVENTY FIVE CENTS (\$2.75) PER THOUSAND CIGARETTES, SUBJECT TO OUR REGULAR CREDIT TERMS FOR THESE TYPES OF CIGARETTES.

WE WILL ACCEPT ORDERS FOR BRANDED AND
GENERIC AND PRIVATE LABEL PRODUCTS RECEIVED
IN OUR DURHAM, NORTH CAROLINA OFFICE
THROUGH JUNE 24, 1988 FOR IMMEDIATE SHIPMENT
AT THE OLD PRICE.

WE THANK YOU FOR YOUR CONTINUED COOPERA-
TION IN THE MARKETING OF OUR PRODUCTS.

LIGGETT & MYERS TOBACCO COMPANY
DURHAM, NORTH CAROLINA 27702

23:26 EST

MGMCOMP

Received Jun 20 1988
Sales Dept.

DURHAM SUN - JULY 28, 1988

1st L&M stockholder session brief; firm said stronger

S JUL 20 '80

By LAURA WOODY

Sun staff writer

Liggett & Myers Tobacco Co's historic First Annual
Stockholders Meeting was over just 10 minutes after it
began.

Fewer than 30 people attended the first stockholder
meeting since the 110-year-old corporation made a public
offering of 4 million shares of common stock in October.

Most who came were L&M employees and not all
were stockholders.

Absent from the meeting was Bennett S. LeBow, a
New York Investor and Liggett owner since October 1986.
He is the majority stockholder with 83 percent of the
company's stock.

Liggett President K.v.R. Dey Jr. told those on hand
that despite industry setbacks, the Durham based tobacco
company has strengthened its financial position by pay-
ing off debts.

"We remain optimistic about our future, but we are
cognizant of the difficult issues that are affecting Liggett
and the industry," Dey said.

"Reduced annual consumption, product liability liti-
gation. Increased taxation and governmental restrictions
increasing social pressures and competitive pressures
place us in a tough business environment."

Dey said "niche marketing" will continue to be the focus of the Company and that two new products are doing well.

Eve Ultra Lights 120s are being sold to retailers and soon will be on the market, Dey said. The product is an extension of Eve Lights 120s in the full-priced cigarette category.

He said the new product is an example of the marketing directed at specific consumer groups Liggett is pursuing.

"We're the smallest of six cigarette companies and we're after those niches," Dey said, "Eve is a slim cigarette with a floral pattern that has traditionally appealed to females and the ultra light will appeal to different smokers.

"We are also encouraged with the performance of Omni 30s, a value-added product now on the market in Japan and we expect to capitalize on future international opportunities."

He said it may be a year or two before income from the Japan ventures begins in earnest.

"We expect our sales in Japan to account for 10 percent of our sales over time," Dey said.

The inexpensive, generic cigarettes once popular with smokers are fading out of favor, but Dey said he is optimistic that growth in the mid-priced branded cigarettes will continue an upswing.

Liggett had success in the early 1980s by being the first cigarette company to enter the generic market. Dey,

however, said the generics' market share is steadily declining now, as smokers choose the "price-value category of cigarettes such as Doral and Cambridge.

"With generics we entered a niche no one else knew was there and we encountered considerable competition," Dey said, "Now our business across the board is better than it's ever been."

With its recently acquired \$30 million line of credit, Liggett is considering diversifying from the tobacco business by entering another business, such as candy, to complement its cigarette line.

Although L&M had signed a "letter of intent" to purchase a candy company last September, Dey said, it withdrew in the final week.

"It didn't fit some of our particulars and we decided to continue looking around," he said.

For the fiscal year ended March 31, net sales were \$(Ill.) million and net income was \$(Ill.) million, or \$1(Ill.) a share.

During the first quarter this year, net sales were \$122.3 million, down from \$142.3 million for the same period a year ago. Net earnings were \$(Ill.) million, or 22 cents a share, compared with a net income of \$94 million or 47 cents a share, last year.

Liggett Group also declared quarterly cash dividend of 1 cents a share, payable on Aug. 27 to stockholders of record on Aug. 8.

Liggett reduced its debt to \$103 million with proceeds from the sale of stock and cash from operations. Dey said \$34.8 million in long term debt remains.

The initial price of Liggett stock was \$12 a share and is now hovering at \$8 a share.

All five items that were voted on, including five directors, were approved, with all stockholders voting by mail.

Those named directors for the next year are Dey; LeBow; and William Wehael, chairman of the board and an officer and director of various companies controlled by LeBow; Clarence W. [Illegible] and Gene D. Hoffman.

The company yesterday announced it will discontinue quarterly "inventory loading" incentive program that encourages retailers to buy large amounts of cigarettes early in the quarter.

The large blocks of purchase were causing irregular sales [Illegible].

[Handwritten Notes]

1-5-88

Gregory F. Theriault
ID 35484

Waterville, ME
Code 01D07D

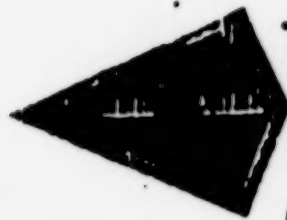
Rec 1/4/89

Christopher Whal [Illegible]
Madison, ME

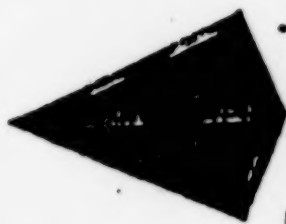
David Christopher
6:45 AM



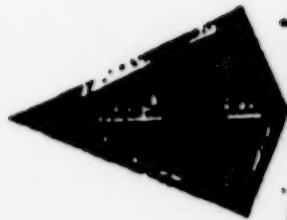
Pyramid



Pyramid
Ultra Lights



Pyramid
Lights



Pyramid

Pyramid
Lights
Filter Kings

Filter 100's



Pyramid

[Handwritten Notes]

Gregory F. Theriault
ID 35484
Waterville, ME
CODE 01D07D

Rec 1/4/89
Christopher S. Wh[Illegible]
Madison, ME
David Christopher
6:45 AM

December 12, 1988

To: Region Managers
Regional Account Managers
District Managers
National Account Managers

From: Ennis Laws

Subject: Pyramid - New Product Introduction

If the price spread between generics and full-priced cigarettes narrows, smokers are switching to branded generics which are priced competitively with generics and also heavily couponed. Net/net branded generics as opposed to generics now represent the lowest pricing concept in this marketplace; and, as a result, smokers are migrating toward the branded generic concepts. Pyramid offers brand name assurance of quality as well as the *lowest price* in the market and future price and excise tax increases will only magnify its appeal.

Pyramid, brand name quality with a new low price.

Since the communication of the price points spread is critical, this brand should be targeted to high volume accounts where you can gain retailer support - i.e.,

- Price Clubs
- State line outlets
- Indian stores
- Large independents
- Chains (that cooperate)

You should develop a plan *market area by market area* to take full advantage of this program where it makes good business sense.

Introductory Deal \$12.00 off invoice per 12M case. A copy of the trade announcement and product specifications is attached for your use. Shipping is planned for December 15 from Durham.

Distribution Allowance of \$.08 per carton will apply to all product purchased. Payment of this allowance will also be deducted off invoice.

Order Procedure will be the same as we used for Savvy and Chesterfield Filter. Initially you should anticipate a two (2) week lead time on all orders. The Liggett representative should phone these orders directly to the Order Department. If you have a warehouse that must have back-up inventory to support a direct customer's purchases, please coordinate with Mr. Leroy Duke in the Order Department. We will start in January to build inventory in all warehouse locations to support turnover orders.

* * *

[Handwritten Notes]

Gregory F. Theriault
ID 35484
Waterville, ME
Code 01D07D

Rec 1/4/89

David Christopher
Christopher Wh[Illegible]
6:45 AM

STATUS OF OUR COMPANY

- BRANDED FULL PRICE CIGARETTES ARE LIFE BLOOD
- NEW BRANDS ARE RIFLE-SHOT MARKETING
- \$3.50 OFF BRANDS OFFER OPPORTUNITY
- GENERIC BRANDS ARE PROFITABLE
 - DEFENSIVE MODE
 - NO EQUITY OR OWNERSHIP
- PRIVATE LABEL BRANDS
 - NO OWNERSHIP OR EQUITY
 - BRAND OWNER CONFUSION

* * *

[Handwritten Notes]

Rec 1/4/89
 Christopher Wh[Illegible]
 Madison, ME
 David Christopher
 6:45 AM

Gregory F. Theriault
 ID 35484
 Waterville, ME
 Code 01D07D

NEW PRICES

	<u>KING</u>	<u>100MM</u>	<u>AVG.</u>	<u>FROM BRANDED</u>
BRANDED	\$8.73	\$9.03	\$8.88	- 0 -
\$3.50 OFF (LIST)	\$8.23	\$8.53	\$8.38	-\$.50
DORAL/ CAMBRIDGE	\$6.35	\$6.60	\$6.475	-\$2.405
L&M GENERIC/ UPSCALE	\$6.25	\$6.50	\$6.375	-\$2.505
\$3.50 OFF (LESS COUPON)	\$4.73	\$5.03	\$4.88	-\$4.00
PYRAMID	\$3.85	\$4.10	\$3.975	-\$4.905
PRIVATE LABEL CONTRACT*	\$3.72	\$3.97	\$3.845	-\$5.035

*CONTRACT PRICE MAY NOT BE INVOICE PRICE
 BECAUSE CAN BE RAISED BY TRADEMARK OWNER.

Industry Update

THE MAXWELL CONSUMER REPORT

1988 YEAR END SALES ESTIMATES
 FOR THE CIGARETTE INDUSTRY

JOHN C. MAXWELL, JR.
 (804) 782-3630

JANUARY 27, 1989
 WFS-2436

* * *

RJR NABISCO, INC.

1988 YEAR-END BRAND SALES AND MARKET SHARES

	Sales (M. Units)			Market Shares (%)				
	1987	1988	Change	1988	1987	1986	1985	1984
WINSTON								
Soft Pack 85s (16)	26.48	24.79	(6.4)	4.4	4.6	4.8	5.0	5.3
Hard Pack 85s (17)	2.72	2.69	(1.1)	0.5	0.5	0.5	0.5	0.4
100s (18)	9.51	8.89	(6.5)	1.6	1.7	1.7	1.9	1.9
Lights 85s (11)	11.00	11.26	(3.7)	2.0	2.0	2.0	2.0	2.1
Lights 100s (11)	7.87	7.44	(5.5)	1.3	1.4	1.4	1.4	1.5
Lights 85 Box (11)	1.17	1.02	(12.8)	0.2	0.2	0.1	-	-
Lights 100s Box (10)	0.58	0.52	-	0.1	0.1	0.1	-	-
Ultra 85s (5)	1.22	1.32	8.2	0.2	0.2	0.2	0.2	0.2
Ultra 100s (5)	2.04	2.08	2.0	0.4	0.4	0.4	0.3	0.3
Total	63.28	60.01	(5.2)	10.7	11.1	11.2	11.3	11.7
SALEM								
85s (17)	10.53	9.41	(10.8)	1.7	1.8	1.9	2.1	2.2
100s (17)	6.90	6.30	(8.7)	1.1	1.2	1.3	1.3	1.4
Lights (10)	10.86	9.83	(11.3)	1.7	1.9	1.9	1.9	1.9
Long Lights (10)	8.34	7.49	(10.2)	1.4	1.5	1.6	1.6	1.6
Lights 100s Box (12)	0.83	0.69	-	0.1	0.1	-	-	-
Ultra Lights 85s (5)	1.43	1.67	16.8	0.3	0.3	0.2	0.2	0.2
Ultra Lights 100s (5)	2.63	2.79	6.1	0.5	0.5	0.4	0.4	0.4
Slim Lights 100s (8)	2.28	2.55	11.8	0.5	0.4	0.4	0.4	0.4
Total	43.80	40.53	(7.5)	7.3	7.7	7.8	7.9	8.1
DORAL								
85s Filter (12)	3.27	3.08	(5.8)	0.6	0.6	0.6	0.6	0.7
Menthol Filter (12)	1.73	1.68	(2.9)	0.3	0.3	0.3	0.5	0.5
100s Filter (12)	4.77	4.58	(4.0)	0.8	0.8	0.8	0.2	0.2
100s Menthol Filter (12)	2.96	3.06	3.4	0.6	0.5	0.4	0.1	0.1
Full Flavor 85s (17)	1.33	1.74	30.8	0.3	0.2	-	-	-
Full Flavor 100s (14)	1.74	2.47	40.3	0.4	0.3	-	-	-
Ultra Lts. Filter 100s (7)	1.40	2.09	48.3	0.4	0.3	-	-	-
Total	17.22	18.70	8.6	3.4	3.0	2.1	1.4	1.5
VANTAGE								
85s (11)	7.40	6.58	(10.9)	1.2	1.3	1.4	1.5	1.6

Menthol (10)	1.23	1.11	(9.8)	0.2	0.2	0.7	0.3	0.3
100s (9)	3.87	3.60	(9.6)	0.6	0.7	0.2	0.7	0.6
Menthol 100s (9)	0.36	0.35	-	-	-	0.1	0.1	0.1
Ultra Lights 85s (5)	2.15	2.20	2.2	0.4	0.4	0.3	0.3	0.3
Ultra Lights 100s (5)	2.79	2.74	(1.8)	0.5	0.5	0.5	0.4	0.4
Total	<u>17.80</u>	<u>16.48</u>	(7.4)	<u>2.0</u>	<u>3.1</u>	<u>3.2</u>	<u>3.3</u>	<u>3.5</u>
CAMEL								
Filter Soft Pack (16)	6.01	6.14	2.2	1.1	1.0	1.1	1.1	1.1
Filter Hard Pack (17)	0.06	1.33	-	0.2	0.2	0.2	0.1	0.1
Filter 100s (18)	0.40	0.38	-	0.1	0.1	-	-	-
Lights Hard Pack 80s (10)	0.83	1.11	-	0.2	0.2	0.2	0.2	0.1
Lights 85s (9)	6.28	5.46	3.4	1.0	0.0	0.8	0.9	1.0
Lights 100s (12)	1.75	1.70	(2.9)	0.3	0.3	0.3	0.3	0.3
Total	<u>16.23</u>	<u>16.12</u>	[III.]	<u>2.9</u>	<u>2.7</u>	<u>2.6</u>	<u>2.6</u>	<u>2.6</u>
BARCLAY								
85s (1)	1.02	0.91	-	0.2	0.2	0.2	0.3	0.3
100s (3)	0.76	0.64	-	0.1	0.1	0.2	0.2	0.2
Box (1)	.32	0.28	-	-	0.1	0.1	0.1	0.1
Menthol 85s (1)	0.02	-	-	-	-	-	-	0.1
Menthol 100s (3)	0.02	-	-	-	-	-	-	-
Total	<u>2.14</u>	<u>1.83</u>	(14.4)	<u>0.3</u>	<u>0.4</u>	<u>0.5</u>	<u>0.6</u>	<u>0.7</u>
RICHLAND 25's								
85s (17)	0.87	0.43	-	0.1	0.1	0.2	0.2	-
100s (17)	0.88	0.52	-	0.1	0.1	0.1	-	-
Menthol 85s (18)	0.57	0.28	-	0.1	0.1	0.1	0.1	-
Lights 85s (10)	0.39	0.14	-	-	0.1	0.1	0.1	-
Lights 100s (12)	0.55	0.24	-	-	0.1	0.1	-	-
Total	<u>3.26</u>	<u>1.61</u>	[III.]	<u>0.3</u>	<u>0.5</u>	<u>0.6</u>	<u>0.4</u>	<u>-</u>
ALL OTHERS***-								
TOTAL FILTER	62.05	60.55	(2.4)	10.8	10.9	11.5	11.7	11.2
Raleigh (King)** (25)	0.37	0.30	-	0.1	0.1	0.1	0.1	0.1
Kool (Regular) (20)	0.29	0.24	-	-	-	0.1	0.1	-
TOTAL DOMESTIC	62.71	61.09	(2.6)	10.9	11.0	11.7	11.9	11.3
Filter % of B&W Total	98.9%	99.1%		99.1%	96.9%	96.9%	98.8%	96.6%

*Includes Felcon Lights.

**couponed cigarettes

***Includes several full service and economy segment test products.

* * *

LIGGETT GROUP INC.

1988 YEAR-END BRAND SALES AND MARKET SHARES

	Sales (M. Units)			Market Shares (%)					
	1987	1988	Change	1988	1987	1986	1985	1984	
GENERICs									
85s	3.80	2.55	(32.9)	0.5	0.7	0.9	1.2	1.5	
100s	4.46	3.13	(29.8)	0.5	0.8	1.1	1.4	1.6	
Menthol 85s	1.03	0.66	-	0.1	0.2	0.3	0.4	0.4	
Menthol 100s	1.40	0.94	-	0.2	0.2	0.3	0.4	0.5	
Total	<u>10.69</u>	<u>7.28</u>	(31.9)	1.3	<u>1.9</u>	<u>2.6</u>	<u>3.4</u>	<u>4.0</u>	
CLASS A									
Class A	1.93	1.71	(11.4)	0.3	0.3	-	-	-	
Class A Deluxe	0.10	0.15	-	-	-	-	-	-	
Total	<u>2.03</u>	<u>1.86</u>	(8.4)	0.3	<u>0.3</u>	<u>-</u>	<u>-</u>	<u>-</u>	
EVE									
Slim Lights (13)	0.14	0.10	-	-	-	0.1	-	0.1	
Menthol 100s (13)	0.08	0.06	-	-	-	-	-	-	
120s (12)	1.14	1.08	[III.]	0.2	0.2	0.2	0.2	0.2	
Menthol 120s (13)	0.74	0.71	-	0.2	0.2	0.1	0.1	0.1	
Total	<u>2.10</u>	<u>1.95</u>	(7.1)	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.3</u>	<u>0.4</u>	
L&M									
85s Soft Pack (13)	1.66	1.31	(21.1)	0.2	0.3	0.3	0.4	0.4	
85s Hard Pack (14)	0.03	0.02	-	-	-	-	-	-	
100s (14)	0.47	0.36	-	0.1	0.1	0.1	0.1	0.1	
Lights (8)	0.11	0.08	-	-	-	-	-	-	
Total	<u>2.27</u>	<u>1.77</u>	(22.0)	<u>0.3</u>	<u>0.4</u>	<u>0.4</u>	<u>0.5</u>	<u>0.5</u>	

LARK									
85s (14)	0.30	0.24	-	-	0.1	-	0.1	0.1	0.1
100s (15)	0.15	0.12	-	-	-	-	-	-	-
Lights 85s (13)	0.50	0.39	-	0.1	0.1	0.1	0.1	0.1	0.1
Lights 100s (14)	0.37	0.29	-	0.1	0.1	0.1	0.1	0.1	0.1
Total	<u>1.32</u>	<u>1.04</u>	(21.2)	<u>0.2</u>	<u>0.3</u>	<u>0.2</u>	<u>0.3</u>	<u>0.3</u>	<u>0.3</u>
ALL OTHERS**	0.07	0.37	-	0.1	-	-	0.1	-	-
TOTAL FILTER	18.48	14.27	(22.8)	2.6	3.3	3.6	4.6	5.2	5.2
CHESTERFIELD									
King* (25)	1.55	1.21	(21.9)	0.2	0.3	0.3	0.3	0.4	0.4
Regular* (20)	0.25	0.18	-	-	-	-	0.1	0.1	0.1
TOTAL DOMESTIC	20.28	15.06	(22.8)	2.8	3.6	3.9	5.0	5.7	5.7
Filter % of Lig. Total	91.1%	91.1%		91.1%	91.1%	91.*%	92.5%	92.7%	92.7%
*Couponed Cigarettes									
**Include new products									

[illegible]

Total Consumption	[III.]	668.12	(2.1)
Total Production	[III.]	660.00	(4.7)
Change in Inventory	[III.]	(8.12)	-

Source: [Illegible]

Figures in parentheses in the brand name [Illegible]

[*=Illegible]

[Handwritten Note]
[May 1989]

U.S. Distribution Journal
Vol. 216, No. 5

UPFRONT

Pyramid program eyed

Liggett maintains price point still key

NASHVILLE, TN: Liggett & Myers Tobacco Co. is developing a trade program for its ultra low priced Pyramid cigarettes, but one that will not sacrifice Pyramid's retail price point, a Liggett executive said.

"We're evaluating a Pyramid program." Liggett President K.v.R. Dey told *U.S. Distribution Journal* at the recent National Association of Tobacco Distributors convention "We're addressing the position of the wholesaler. We don't want to loose the interest of wholesalers."

Liggett introduced the stylishly-packaged Pyramid Lights, which was designed to retail for between 60 cents and 80 cents - last December. To keep the price low, Liggett's strategy was to eschew national advertising and trade promotion.

Yet, while trade margins on Pyramid are similar to many full-price national brands, Dey confirmed many wholesalers have been reluctant to carry the brand.

Wholesalers maintain Pyramid in effect "competes" with Liggett black-and-white Quality Seal generics, for which they are eligible for rebates and other PMs.

Pyramid has gained distribution through membership clubs, mass merchandisers, and other direct discounters, Dey said. To appeal to a broad segment of smokers, the rollout included five styles Light Kings, Light 100s, Menthol 100s, Ultra-Light 100s and Non-Filter Kings.

"We know there is a place for Pyramid, in that it has been accepted by the consumer," Dey maintained, "but the key to its [long-term viability] is maintaining the [price] differential at retail."

Dey said it's too early to quantitatively evaluate Pyramid's level of acceptance, though the company is gathering data on who is buying the brand.

Liggett expects some sales of Pyramid to come at the expense of the black-and-white generics, a category the company pioneered in 1981 and whose market share has been declining dramatically in recent years.

"The black-and-white category across all consumer goods has diminished greatly. Cigarettes are the last to survive to any significant degree," Dey said. The demise of generic cigarettes can be traced to the success of price-value brands.

Dey said nine cigarette pricing levels exist, closing the gap between what was traditionally considered full-price and price-value brands. Pyramid was designed to create a district price level.

"We're the niche player in the cigarette industry," Dey said, "We can't get into a battle of marketing incentives."

[Extraneous Material Deleted in Printing]

[In evidence 7/12/89]

Annual Market Share (in percentages) of all
Generic Cigarettes in the United States
Cigarette Market (1980-1988)

<u>Date</u>	<u>Share of Market(%)</u>
1980	0
1981	0.4
1982	0.9
1983	2.9
1984	4.4
1985	4.7
1986	4.5
1987	4.1
1988	3.3

(Source: Plaintiff's Trial Exhibits 3648, 3649, 3651, 3659, 3672, 3655, 3656, 3658)

[In Evidence 7/12/89]

Liggett & Myers Generic Cigarettes (King Size)

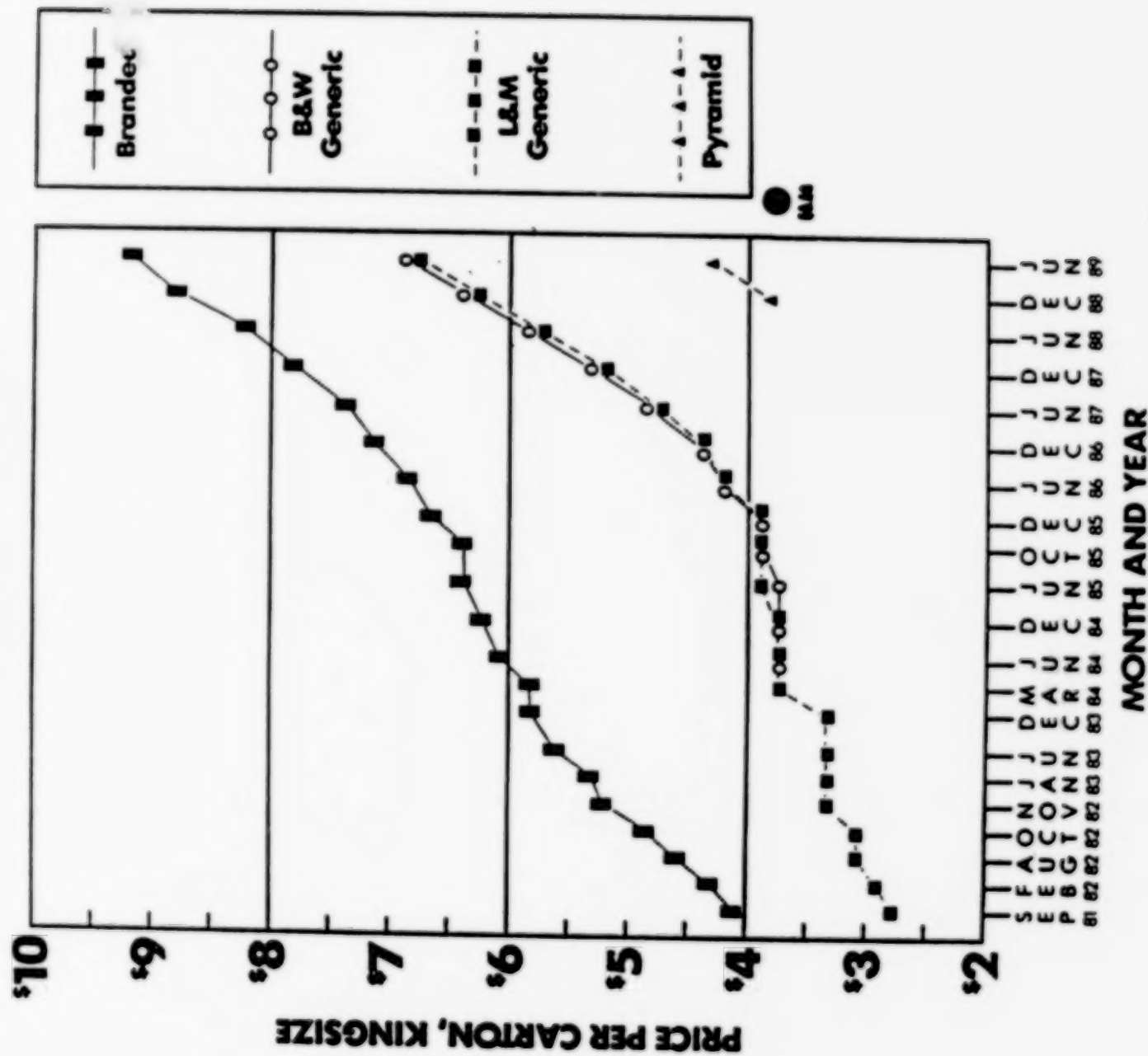
List Price Differential Between Branded Cigarettes and Generic Cigarettes*

	1980		1981		1982		1983				1984	
	May	Nov.	April	Sept.	Feb.	Aug. Sept.	Oct.	Nov.	Jan.	June	Dec.	Mar.
Branded (\$/M)	17.65	18.50	19.35	20.20	21.20	22.70	24.70	26.20	26.90	28.40	29.15	29.15
Generics (\$/M)	12.45	13.30	13.30	13.65	14.50	15.25	15.25	17.25	17.25	17.25	17.25	18.75
Savings (\$/M)	5.20	5.20	6.05	6.56	6.70	7.45	9.45	8.95	9.65	11.15	11.90	10.40
Savings (%)	29.46%	28.11%	31.26%	32.43%	31.60%	32.81%	38.26%	34.16%	35.87%	39.26%	40.82%	35.68%
			<u>1985</u>		<u>1986</u>		<u>1987</u>		<u>1988</u>		<u>1989</u>	
	June	Dec.	June	Dec.	June	Dec.	June	Dec.	June	Dec.	June	
Branded (\$/M)	30.15	31.15	32.15	33.15	34.40	35.65	37.15	39.15	41.15	43.65	46.15	
Generics (\$/M)	18.75	18.75	19.75	19.75	21.00	22.25	23.50	26.00	28.75	31.25	33.75	
Savings (\$/M)	11.40	12.40	12.40	13.40	13.40	13.40	13.65	13.15	12.40	12.40	12.40	
Savings (%)	37.81%	39.80%	38.57%	40.42%	38.95%	37.50%	36.74%	33.50%	30.13%	28.40%	26.87%	

(Source: Plaintiff's Trial Exhibits 7000, 3655, 3656, 3657, 3684, 2066, 2094, 4413, 1998, 2069, 2092 and 4414)

* The list price noted for Liggett & Myers' generic cigarettes apply to Liggett & Myers' generic cigarettes other than for private label chains.

LIST PRICE FOR CIGARETTES, Branded & Generic, 1981-1989



[In Evidence 8/9/89]

SUMMARY OF DOCUMENTS SHOWING LIGGETT & MYERS' REBATE PROGRAMS FOR ITS FRANCHISEES AND B&W'S REBATE PROGRAMS AS ANNOUNCED TO SALES PERSONNEL JUNE 4-JULY 20, 1984¹

(B&W/s program was effective with first shipment of generics on or about July 17, 1984.

Liggett's program was effective August 1, 1984)

Cases Per Quarter	B&W June 4	L&M June 11 ²	B&W June 21	L&M June 22 ²	B&W June 29	L&M July 6	B&W July 10	L&M July 13	B&W July 17	L&M July 20
0-99	0¢	0¢	20¢	20¢	30¢	30¢	55¢	45¢	60¢	50¢
100-199	10¢	5¢	30¢	25¢	40¢	35¢	55¢	45¢	60¢	50¢
200-499	15¢	5¢	35¢	25¢	45¢	35¢	55¢	45¢	60¢	50¢
500-999	20¢	10¢	40¢	33¢	50¢	43¢	60¢	53¢	65¢	58¢
1000-1499	25¢	15¢	45¢	38¢	55¢	48¢	65¢	58¢	70¢	63¢
1500-7999	30¢	20¢	50¢	43¢	60¢	53¢	70¢	63¢	75¢	68¢
8000+	30¢	20¢	50¢	43¢	60¢	53¢	75¢	68¢	80¢	73¢
Source (Plaintiff Trial Exhibits	16	4111 3286	4079	3310	4081	3375 3376	437	4082	33 3341 3475 4369	4112 3354

¹ Some time after B&W entered, Liggett & Myers included its franchise incentive payments as part of its total rebate program and, therefore, it is included on this summary starting June 22.

² Liggett's program mentioned a possible incremental program whereby a customer could earn 5 cents per carton if it exceeded its base level. This program was never implemented and was superceded by Liggett's July 6 program. The figures under this column, therefore, do not include the 5¢ incremental payment which is impossible to value and which would not have applied to Liggett's existing volume.

[In Evidence 8/9/89]

SUMMARY OF DOCUMENTS SHOWING LIGGETT & MYERS' REBATE PROGRAMS FOR BROKER CUSTOMERS AND B&W'S REBATE PROGRAMS AS ANNOUNCED TO SALES PERSONNEL JUNE 4-JULY 20, 1984

(B&W's program was effective with first shipment of generics on or about July 17, 1984.

Liggett's program was effective August 1, 1984)

Cases Per Quarter	B&W June 4	L&M June 11 ¹	B&W June 21	L&M June 22 ^{1 2}	B&W June 29	L&M July 6	B&W July 10	L&M July 13	B&W July 17	L&M July 20
0-99	0¢	0¢	20¢	22.2¢	30¢	32.2¢	55¢	47.2¢	60¢	52.2¢
100-199	10¢	5¢	30¢	27.2¢	40¢	37.2¢	55¢	47.2¢	60¢	52.2¢
200-499	15¢	5¢	35¢	27.2¢	45¢	37.2¢	55¢	47.2¢	60¢	52.2¢
500-999	20¢	10¢	40¢	32.2¢	50¢	42.2¢	60¢	52.2¢	65¢	57.2¢
1000-1499	25¢	15¢	45¢	37.2¢	55¢	47.2¢	65¢	57.2¢	70¢	62.2¢
1500-7999	30¢	20¢	50¢	42.2¢	60¢	52.2¢	70¢	62.2¢	75¢	67.2¢
8000+	30¢	20¢	50¢	42.2¢	60¢	52.2¢	75¢	67.2¢	80¢	72.2¢
Source (Plaintiff Trial Exhibits	16	4111 3286	4079	3310	4081	3375 3376	437	4082	33 3341 3475 4369	4112 3354

¹ Liggett's program mentioned a possible incremental program whereby a customer could earn 5 cents per carton if it exceeded its base level. This program was never implemented and was superceded by Liggett's July 6 program. The figures under this column, therefore, do not include the 5¢ incremental payment which is impossible to value and which would not have applied to Liggett's existing volume.

² The rebates listed are 12.2¢ higher than Liggett's published program to include the program Liggett's brokers GPC and Federated offered to customers.

[In Evidence 8/24/89]

[Handwritten Notes]

Generic Cigs

V & L	27.513
Sales rev. @18.72	<u>514.800</u>
Variable Margin @4.77	<u>131.175</u>
Volume Rebates @3.73	102.575
Sticker Program	<u>28.645</u>
Adjusted Margin	<.45>
Mkt. Cert.	-
Selling Field	1.000
G & A	2.000
Deprec-	5.000
C&C Mfg.	<u>13.750</u>
Capacity Income	<u>(\$21.795) + \$33.306 = \$11.511</u>

[In Evidence 9/27/89]

B&W Generic Cigarettes (King Size)

List Price Differential Between Branded Cigarettes and Generic Cigarettes

	<u>1982</u>				<u>1983</u>				<u>1984</u>		<u>1985</u>		<u>1986</u>		<u>1987</u>		<u>1988</u>		<u>1989</u>
	Aug.	Feb.	Sept.	Oct.	Nov.	Jan.	June	Dec.	Mar.	June	Dec.	June	Dec.	June	Dec.	June	Dec.	June	Dec.
Branded (\$/M)										30.15	31.15	32.15	33.15	34.40	35.65	37.15	39.15	41.15	43.65
Generics (\$/M)										18.75	18.75	18.75	19.75	21.00	22.25	23.75	26.50	29.25	31.75
Savings (\$/M)										11.40	12.40	13.40	13.40	13.40	13.40	13.40	12.65	11.90	11.90
Savings (%)										37.81%	39.80%	41.68%	40.42%	38.95%	37.59%	36.07%	32.31%	28.92%	27.26%

(Source: Plaintiff's Trial Exhibits 7000, 3655, 3656, 3657, 3684, 2066, 2094, 4413, 1998, 2069, 2092 and 4414)

[In Evidence 10/3/89]

DEPARTMENT OF JUSTICE MERGER
GUIDELINES CONCENTRATION
STANDARDS

Herfindahl-Hirschman Index

Less than 1000 - Unconcentrated

1000 - 1800 - Moderately Concentrated

Greater than 1800 - Highly Concentrated

Source: U.S. Department of Justice Merger Guidelines

[In Evidence 10/3/89]

U.S. CIGARETTE SALES
MARKET SHARE AND CONCENTRATION

	<u>1982</u>	
	<u>Units Sold</u>	<u>Market Share</u>
	(Billions)	(%)
R.J. Reynolds	208.79	33.4
Philip Morris	204.43	32.8
Brown & Williamson	83.18	13.3
American	55.35	8.9
Lorrillard	54.36	8.7
Liggett & Myers	<u>17.90</u>	<u>2.9</u>
Total	624.01	100.0
Four Firm Concentration	88.4	
Herfindahl-Hirschman Index	2532	

SOURCE: 1982 Maxwell Report: Revised Year-End Sale
Estimates for the Cigarette Industry

[In Evidence 10/4/89]

CIGARETTE INDUSTRY PROFITABILITY
CIGARETTE INDUSTRY PROFITABILITY COMPARED
TO FOOD AND KINDRED PRODUCT
INDUSTRY PROFITABILITY

PRE-TAX RETURN ON STOCKHOLDERS EQUITY

	<u>1979 - 1985</u>	
	<u>Food & Kindred Product Industry Profitability</u>	<u>Tobacco Industry Profitability</u>
1985	21.3%	35.4%
1984	20.8%	34.1%
1983	19.8%	29.8%
1982	20.4%	30.3%
1981	22.2%	31.6%
1980	23.5%	31.5%
1979	23.3%	31.5%
1979-1985 Average	<u>21.5%</u>	<u>32.2%</u>

Return on Average Stockholders Equity

Source: United States Government, *Quarterly Financial Reports*

[In Evidence 10/5/89]

BROWN & WILLIAMSON GENERIC CIGARETTES
EXCESS OF VARIABLE COSTS OVER NET REVENUES
FOR THE PERIOD JULY 1984-DECEMBER 1985

18 MONTHS TOTAL: JULY 1984-DECEMBER 1985
(000's Omitted)

Gross Paid Sales		
Including Excise Tax	\$190,602	
Less Excise Tax	<u>80,220</u>	
Net Sales		\$110,382
Less Rebates:		
Trade Rebates	37,626	
DAIP Rebates	2,161	
Interest Credit on Rebates	<u>(718)</u>	
Total: Rebates		<u>39,069</u>
NET REVENUES		\$71,313
Less Variable Costs:		
Variable Manufacturing Cost	\$ 52,071	
Leaf Lifo Expense (adjusts leaf to current cost)	(505)	
SUI Revaluation	984	
Freight, Cartage & Insurance	<u>3,535</u>	
Total: Manufacturing Cost (adjusted) and Freight		56,085

Promotional Costs	1,419	
Direct Selling Costs	850	
Displays	3,311	
Consumer Promotions	9,059	
Generic Leverage Program	<u>1,495</u>	
Total: Selling Costs		16,132
Variable Overhead		5,014
Carrying Costs		7,019
Manufacturing Variances		<u>2,024</u>
TOTAL VARIABLE COSTS		<u>86,275</u>
EXCESS OF VARIABLE COSTS OVER NET REVENUES		<u>\$14,961</u>

NOTE: Numbers may not add to totals by insignificant amounts due to rounding those numbers to thousands.

[In Evidence 10/5/89]

BROWN & WILLIAMSON GENERIC CIGARETTES
 EXCESS OF AVERAGE VARIABLE COSTS
 PER CARTON
 OVER NET REVENUE PER CARTON
 FOR THE PERIOD JULY 1984-DECEMBER 1985

18 MONTHS: JULY 1984-DECEMBER 1985
 PER CARTON

Gross Paid Sales		
Including Excise Tax	\$3.802	
Less Excise Tax	<u>1.600</u>	
Net Sales		\$2.202
Less Rebates:		
Trade Rebates	0.750	
DAIP Rebates	0.043	
Interest Credit on		
Rebates	<u>(0.014)</u>	
Total: Rebates		<u>0.779</u>
NET REVENUES		
PER CARTON		\$1.422
Less Variable Costs:		
Variable Manufacturing		
Cost	\$1.039	
Leaf Lifo Expense		
(adjusts leaf to		
current cost)	(0.010)	
SUI Revaluation	0.020	
Freight, Cartage		
& Insurance	<u>0.071</u>	
Total: Manufacturing Cost		
(adjusted) and		
Freight		1.119

Promotional Costs	0.028
Direct Selling Costs	0.017
Displays	0.066
Consumer Promotions	0.181
Generic Leverage	
Program	<u>0.030</u>

Total: Selling Costs 0.322

Variable Overhead	0.100
Carrying Costs	0.140
Manufacturing Variances	<u>0.040</u>

AVERAGE VARIABLE COSTS
 PER CARTON 1.721

EXCESS OF AVERAGE VARIABLE
 COSTS PER CARTON OVER
 NET REVENUES PER CARTON \$0.298

NOTE: Numbers may not add
 to totals by insignificant
 amounts due to rounding.

[In Evidence 10/5/89]

BROWN & WILLIAMSON GENERIC CIGARETTES
EXCESS OF VARIABLE COSTS OVER NET REVENUES
FOR THE PERIOD JULY 1984-DECEMBER 1985
SUMMARY

(Rounded to Nearest Thousand)

18 MONTHS TOTAL: JULY 1984-DECEMBER 1985

Gross Paid Sales	
Including Excise Tax	\$190,602,000
Less Excise Tax	<u>80,220,000</u>
Net Sales	\$110,382,000
Less Rebates	<u>39,069,000</u>
NET REVENUES.....	\$71,313,000
Less Variable Costs:	
Manufacturing Cost	
(adjusted) and	
Freight	\$56,085,000
Selling Costs	16,132,000
Variable Overhead	5,014,000
Carrying Costs	7,019,000
Manufacturing Variances	<u>2,024,000</u>
TOTAL VARIABLE COSTS	<u>\$86,275,000</u>
EXCESS OF VARIABLE COSTS	
OVER NET REVENUES	<u>\$14,961,000</u>

NOTE: Numbers do not add
to totals by insignificant
amounts due to rounding
those numbers to thousands.

[In Evidence 10/5/89]

BROWN & WILLIAMSON GENERIC CIGARETTES
EXCESS OF AVERAGE VARIABLE COSTS
PER CARTON
OVER NET REVENUE PER CARTON
FOR THE PERIOD JULY 1984-DECEMBER 1985
SUMMARY

18 MONTHS TOTAL: JULY 1984-DECEMBER 1985

Gross Paid Sales	
Including Excise Tax	\$3.802
Less Excise Tax	<u>1.600</u>
Net Sales	\$2.202
Less Rebates	<u>0.779</u>
NET REVENUES PER CARTON.....	\$1.422
Less Variable Costs:	
Manufacturing Cost	
(adjusted) and	
Freight	\$1.119
Selling Costs	0.322
Variable Overhead	0.100
Carrying Costs	0.140
Manufacturing Variances	<u>0.040</u>
AVERAGE VARIABLE COSTS PER CARTON	<u>\$1.721</u>
EXCESS OF VARIABLE COSTS	
PER CARTON OVER NET REVENUES	
PER CARTON	<u>\$0.298</u>

NOTE: Numbers do not add
to totals by insignificant
amounts due to rounding.

BROWN & WILLIAMSON GENERIC CIGARETTES
EXCESS OF VARIABLE COSTS OVER NET REVENUES
FOR THE PERIOD JULY 1984-DECEMBER 1985
(000'S OMITTED)

	3RD QTR 1984	4TH QTR 1984	TOTAL 1984	1ST QTR 1985	2ND QTR 1985	3RD QTR 1985	4TH QTR 1985	TOTAL 1985	TOTAL 84-85
Gross Paid Sales Including									
Excise Tax	\$14,513	\$26,211	\$40,725	\$20,361	\$29,134	\$37,339	\$63,043	\$149,878	\$190,602
Less Excise Tax	6,196	11,174	17,369	8,666	12,371	15,835	25,979	62,851	80,220
Net Sales	8,318	15,038	23,355	11,695	16,763	21,504	37,064	87,027	110,382
Less Rebates:									
Trade Rebates	2,457	4,446	6,903	3,669	5,566	7,843	13,645	30,723	37,626
DAIP Rebates	-	-	-	298	425	544	893	2,161	2,161
Interest Credit on Rebates	(47)	(82)	(129)	(84)	(113)	(148)	(244)	(589)	(718)
Total: Rebates	2,410	4,364	6,774	3,883	5,879	8,239	14,294	32,294	39,069
NET REVENUES	\$5,908	\$10,673	\$16,581	\$7,812	\$10,885	\$13,266	\$22,770	\$54,732	\$71,313
Less Variable Costs:									
Variable Manufacturing Cost	\$4,375	\$7,963	\$12,338	\$6,343	\$7,680	\$9,778	\$15,931	\$39,733	\$52,071
Leaf Life Expense (adjusts Leaf to current cost)	92	165	257	(105)	(150)	(192)	(315)	(762)	(505)
SUI Revaluation	-	-	-	-	984	-	-	984	984
Freight, Cartage & Insurance	248	476	724	368	539	713	1,191	2,811	3,535
Total: Manufacturing Cost (adjusted) and Freight	4,714	8,605	13,319	6,606	9,053	10,299	16,808	42,766	56,085
Promotional Costs	399	264	664	115	568	(252)	323	755	1,419
Direct Selling Costs	36	64	100	103	148	189	310	750	850
Displays	256	461	717	358	511	653	1,072	2,594	3,311
Consumer Promotions	54	1,482	1,536	487	1,144	1,815	4,077	7,522	9,059
Generic Leverage Program	-	1,495	1,495	-	-	-	-	-	1,495
Total: Selling Costs	745	3,766	4,511	1,063	2,370	2,406	5,782	11,621	16,132
Variable Overhead	387	698	1,086	542	773	990	1,624	3,928	5,014
Carrying Costs	542	978	1,520	758	1,082	1,386	2,273	5,499	7,019
Manufacturing Variances	651	1,175	1,826	27	39	50	82	198	2,024
TOTAL VARIABLE COSTS	\$7,040	\$15,221	\$22,261	\$8,996	\$13,318	\$15,130	\$26,569	\$64,013	\$86,275
EXCESS OF VARIABLE COSTS OVER NET REVENUES.....	\$1,132	\$4,548	\$5,680	\$1,185	\$2,433	\$1,865	\$3,799	\$9,281	\$14,961

NOTES:

Total Leaf standard costs as calculated by B&W are included in VARIABLE MANUFACTURING COST.

The Leaf Life Expense for both 1984 and 1985 are adjusted to reflect actual year end data.

Promotional Costs expensed in June 1984 have been combined with the 3rd Quarter 1984 expense.

Numbers may not add to totals by insignificant amounts due to rounding those numbers to thousands.

**BROWN & WILLIAMSON GENERIC CIGARETTES
EXCESS OF AVERAGE VARIABLE COSTS PER CARTON
OVER NET REVENUE PER CARTON
FOR THE PERIOD JULY 1984-DECEMBER 1985**

	3RD QTR 1984	4TH QTR 1984	TOTAL 1984	1ST QTR 1985	2ND QTR 1985	3RD QTR 1985	4TH QTR 1985	TOTAL 1985	TOTAL 84-85
Gross Paid Sales Including									
Excise Tax	\$3.748	\$3.753	\$3.751	\$3.759	\$3.768	\$3.773	\$3,883	\$3,815	\$3.802
Less Excise Tax	1.600	1.600	1.600	1.600	1.600	1.600	1.600	1.600	1.600
Net Sales	2.148	2.153	2.151	2.159	2.168	2.173	2.283	2.215	2.202
Less Rebates:	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Trade Rebates	0.634	0.637	0.636	0.677	0.720	0.792	0.840	0.782	0.750
DAIP Rebates	-	-	-	0.055	0.055	0.055	0.055	0.055	0.043
Interest Credit on Rebates	(0.012)	(0.012)	(0.012)	(0.016)	(0.015)	(0.015)	(0.015)	(0.015)	(0.014)
Total: Rebates	0.622	0.625	0.624	0.717	0.760	0.832	0.880	0.822	0.779
NET REVENUES PER CARTON.....	\$1.526	\$1.528	\$1.527	\$1.442	\$1.408	\$1.340	\$1.402	\$1.393	\$1.422
Less Variable Costs:									
Variable Manufacturing Cost	\$1.130	\$1.140	\$1.137	\$1.171	\$0.993	\$0.988	\$0.981	\$1.011	\$1.039
Leaf Life Expense (adjusts Leaf to current cost)	0.024	0.024	0.024	(0.019)	(0.019)	(0.019)	(0.019)	(0.019)	(0.010)
SUI Revaluation	-	-	-	-	0.127	-	-	0.025	0.020
Freight, Cartage & Insurance	0.064	0.068	0.067	0.068	0.070	0.072	0.073	0.072	0.071
Total: Manufacturing Cost (adjusted) and Freight	1.217	1.232	1.227	1.220	1.171	1.041	1.035	1.089	1.119
Promotional Costs	0.103	0.038	0.061	0.021	0.073	(0.025)	0.020	0.019	0.028
Direct Selling Costs	0.009	0.009	0.009	0.019	0.019	0.019	0.019	0.019	0.017
Displays	0.066	0.066	0.066	0.066	0.066	0.066	0.066	0.066	0.066
Consumer Promotions	0.014	0.212	0.142	0.090	0.148	0.183	0.251	0.191	0.181
Generic Leverage Program	-	0.214	0.138	-	-	-	-	-	0.030
Total: Selling Costs	0.192	0.539	0.416	0.196	0.307	0.243	0.356	0.296	0.322
Variable Overhead	0.100	0.100	0.100	0.100	0.100	0.100	0.100	0.100	0.100
Carrying Costs	0.140	0.140	0.140	0.140	0.140	0.140	0.140	0.140	0.140
Manufacturing Variances	0.168	0.168	0.168	0.005	0.005	0.005	0.005	0.005	0.040
AVERAGE VARIABLE COSTS PER CARTON	\$1.818	\$2.180	\$2.051	\$1.661	\$1.722	\$1.529	\$1.636	\$1.630	\$1.721
EXCESS OF AVERAGE VARIABLE COSTS PER CARTON OVER NET REVENUES PER CARTON ...	\$0.292	\$0.651	\$0.523	\$0.219	\$0.315	\$0.188	\$0.234	\$0.236	\$0.298

NOTES:

Total Leaf standard costs as calculated by B&W are included in VARIABLE MANUFACTURING COST.
The Leaf Life Expense for both 1984 and 1985 are adjusted to reflect actual year end data.
Promotional Costs expensed in June 1984 have been combined with the 3rd Quarter 1984 expense.
Numbers may not add to totals by insignificant amounts due to rounding.

[In Evidence 10/5/89]

BROWN & WILLIAMSON GENERIC CIGARETTES
 EXCESS OF VARIABLE COSTS OVER NET REVENUES
 FOR THE PERIOD JULY 1984-DECEMBER 1985
 SUMMARY
 (000'S OMITTED)

	3RD QTR 1984	4TH QTR 1984	TOTAL 1984	1ST QTR 1985	2ND QTR 1985	3RD QTR 1985	4TH QTR 1985	TOTAL 1985	TOTAL 84-85
Gross Paid Sales									
Including Excise Tax	\$14,513	\$26,211	\$40,725	\$20,361	\$29,134	\$37,339	\$63,043	\$149,878	\$190,602
Less Excise Tax	6,196	11,174	17,369	8,666	12,371	15,835	25,979	62,851	80,220
Net Sales	8,318	15,038	23,355	11,695	16,763	21,504	37,064	87,027	110,382
Less Rebates	2,410	4,364	6,774	3,883	5,879	8,239	14,294	32,294	39,069
NET REVENUES	\$5,908	\$10,673	\$16,581	\$7,812	\$10,885	\$13,266	\$22,770	\$54,732	\$71,313
Less Variable Costs:									
Manufacturing Cost									
(adj.) and Freight	\$4,714	\$8,605	\$13,319	\$6,606	\$9,053	\$10,299	\$16,808	\$42,766	\$56,085
Selling Costs	745	3,766	4,511	1,063	2,370	2,406	5,782	11,621	16,132
Variable Overhead	387	698	1,086	542	773	990	1,624	3,928	5,014
Carrying Costs	542	978	1,520	758	1,082	1,386	2,273	5,499	7,019
Manufacturing Variances	651	1,175	1,826	27	39	50	82	198	2,024
TOTAL VARIABLE									
COSTS	\$7,040	\$15,221	\$22,261	\$8,996	\$13,318	\$15,130	\$26,569	\$64,013	\$86,275
EXCESS OF VARIABLE									
 COSTS OVER NET									
 REVENUES	\$1,132	\$4,548	\$5,680	\$1,185	\$2,433	\$1,865	\$3,799	\$9,281	\$14,961

NOTE: Numbers may not add to totals by insignificant amounts due to rounding those numbers to thousands.

**BROWN & WILLIAMSON GENERIC CIGARETTES
EXCESS OF AVERAGE VARIABLE COSTS PER CARTON
OVER NET REVENUE PER CARTON
FOR THE PERIOD JULY 1984-DECEMBER 1985
SUMMARY**

	3RD QTR 1984	4TH QTR 1984	TOTAL 1984	1ST QTR 1985	2ND QTR 1985	3RD QTR 1985	4TH QTR 1985	TOTAL 1985	TOTAL 84-85
Gross Paid Sales									
Including Excise Tax	\$3.748	\$3.753	\$3.751	\$3.759	\$3.768	\$3.773	\$3,883	\$3,815	\$3.802
Less Excise Tax	1.600	1.600	1.600	1.600	1.600	1.600	1.600	1.600	1.600
Net Sales	2.148	2.153	2.151	2.159	2.168	2.173	2.283	2.215	2.202
Less Rebates	0.622	0.625	0.624	0.717	0.760	0.832	0.880	0.822	0.779
NET REVENUES PER CARTON	\$1.526	\$1.528	\$1.527	\$1.442	\$1.408	\$1.340	\$1.402	\$1.393	\$1.422
Less Variable Costs:									
Manufacturing Cost (adjused) and Freight	1.217	1.232	1.227	1.220	1.171	1.041	1.035	1.089	1.119
Selling Costs	0.192	0.539	0.416	0.196	0.307	0.243	0.356	0.296	0.322
Variable Overhead	0.100	0.100	0.100	0.100	0.100	0.100	0.100	0.100	0.100
Carrying Costs	0.140	0.140	0.140	0.140	0.140	0.140	0.140	0.140	0.140
Manufacturing Variances	0.168	0.168	0.168	0.005	0.005	0.005	0.005	0.005	0.040
AVERAGE VARIABLE COSTS PER CARTON	\$1.818	\$2.180	\$2.051	\$1.661	\$1.722	\$1.529	\$1.636	\$1.630	\$1.721
EXCESS OF AVERAGE VARIABLE COSTS PER CARTON OVER NET REVENUES PER CARTON	\$0.292	\$0.651	\$0.523	\$0.219	\$0.315	\$0.188	\$0.234	\$0.236	\$0.298

NOTE: Numbers may not add to totals by insignificant amounts due to rounding.

[In Evidence 10/5/89]

DATA FROM PLAINTIFF'S EXHIBIT 3968

GENERIC CIGARETTES
CALCULATION OF BROWN & WILLIAMSON'S
FULL VARIABLE MARGIN
FOR THE PERIOD JULY 1984-DECEMBER 1985
(Rounded to Nearest Thousand)

18 MONTHS TOTAL: 1984-1985

Gross Paid Sales Including Excise Tax	\$190,602,000
Less: Excise Tax	\$80,220,000
Manufacturing Cost (adjusted) and Freight	<u>56,085,000</u>
	<u>136,305,000</u>
FULL VARIABLE MARGIN	<u>\$54,297,000</u>

[In Evidence 10/5/89]

GENERIC CIGARETTES
EXCESS OF BROWN & WILLIAMSON'S
VARIABLE EXPENDITURES
OVER FULL VARIABLE MARGIN
FOR THE PERIOD JULY 1984-DECEMBER 1985
(Rounded to Nearest Thousand)

18 MONTHS TOTAL: 1984-1985

Full Variable Margin (from chart above).....	\$54,297,000
Less: Rebates	\$39,069,000
Variable Selling Costs	<u>16,132,000</u>
SPENT TO DISPLACE LIGGETT.....	<u>55,201,000</u>
Excess of Amount Spend to Displace Liggett Over Full Variable Margin	904,000
Variable Costs Not Covered by Full Variable Margin:	
Variable Overheads	5,014,000
Carrying Costs	7,019,000
Manufacturing Variances	<u>2,024,000</u>
EXCESS OF VARIABLE EXPENDITURES OVER FULL VARIABLE MARGIN	<u>\$14,961,000</u>

[In Evidence 10/5/89]

DATA FROM PLAINTIFF'S EXHIBIT 3969

GENERIC CIGARETTES
CALCULATION OF BROWN & WILLIAMSON'S
FULL VARIABLE MARGIN PER CARTON
FOR THE PERIOD JULY 1984-DECEMBER 1985

18 MONTHS: 1984-1985

Gross Paid Sales Including Excise Tax	\$3.802
Less: Excise Tax	\$1.600
Manufacturing Cost (adjusted) and Freight	<u>1.119</u>
	<u>2.719</u>
FULL VARIABLE MARGIN PER CARTON	<u>\$1.083</u>

[In Evidence 10/5/89]

<p>GENERIC CIGARETTES EXCESS OF BROWN & WILLIAMSON'S AVERAGE VARIABLE EXPENDITURES PER CARTON OVER AVERAGE FULL VARIABLE MARGIN PER CARTON FOR THE PERIOD JULY 1984-DECEMBER 1985</p>	
	<u>18 MONTHS: 1984-1985</u>
Full Variable Margin Per Carton (from chart above).....	\$1.083
Less: Rebates Per Carton	\$0.779
Variable Selling Costs Per Carton	<u>0.322</u>
AVERAGE SPENT PER CARTON TO DISPLACE LIGGETT.....	<u>\$1.101</u>
Excess of Average Amount Spent Per Carton to Displace Liggett Over Average Full Variable Margin Per Carton	\$0.018
Average Variable Costs Per Carton Not Covered by Average Variable Margin Per Carton:	
Variable Overhead	0.100
Carrying Costs	0.140
Manufacturing Variances	<u>0.040</u>
EXCESS OF AVERAGE VARIABLE EXPENDITURES PER CARTON OVER AVERAGE FULL VARIABLE MARGIN PER CARTON	<u><u>\$0.298</u></u>

[In Evidence 2/2/90]

MSA CIGARETTE INDUSTRY REPORT
U.S. TOTAL REPORT
DECEMBER 1989

Prepared For
BROWN & WILLIAMSON TOBACCO CORPORATION
[LOGO]
MANAGEMENT SCIENCE ASSOCIATES, INC.
MARKET SCIENCE ASSOCIATES

* * *

BRANDS INCLUDED IN:VALUE FOR MONEY SEGMENTPlain/Private Label

Liggett Generics - All
B&W Generics - All
PM Generics - All
RJR Generics - All

Low Price Branded 20's

Doral KSF (New)
Doral KSF Men (New)
Doral 100
Doral 100 Men
Doral Full Flavor 85 Men
Doral Full Flavor KSF
Doral Full Flavor 100
Doral Full Flavor 100
Men
Doral Full Flavor KSF
Box

Low Price Branded 20's
(cont'd)

Falcon Light KSF
 Falcon Light KSF Men
 Falcon Light 100
 Falcon Light 100 Men
 Malibu 100
 Malibu 100 Men
 Malibu Light 100
 Malibu KSF
 Malibu KSF Men
 Malibu Light KSF
 Malibu ULT 100
 Magna FF KSF (PV)
 Magna FF KSF Box (PV)
 Magna Lt KSF (PV)
 Magna Lt KSF Box (PV)
 American Light KSF
 American Light 100
 American Light 100 Men
 American Filter 85
 American Filter 100
 Chesterfield Lt KSF
 Chesterfield Lt 100
 Savvy Light 100
 Savvy Light 100 Men
 Savvy Ultra Light 100
 Alpine KSF Men (PV)
 Alpine Light KSF Men
 (PV)
 Alpine 100 Men (PV)

Low Price Branded 20's
(cont'd)

Alpine Light 100 Men
 (PV)
 Alpine KSF Box Men
 (PV)
 Alpine Light Box Men
 (PV)
 Viceroy KSF (PV)
 Viceroy Light KSF (PV)
 Viceroy 100 (PV)
 Viceroy Light 100 (PV)
 Misty Slim Lt 100 Box
 (PV)
 Misty Slim Lt 100
 Box Men (PV)
 Lucky Strike Lotar KSF
 Lucky Strike Lotar KSF
 Box
 Lucky Strike Lotar 100
 Lucky Strike Light KSF
 Lucky Strike Light 100
 Belair KSF (PV)
 Belair Lt KSF (PV)
 Belair 100 (PV)
 Belair Lt 100 (PV)
 Pall Mall Red KSF
 Harley-Davidson KSF
 (PV)
 Harley-Davidson LT KSF
 (PV)

Low Price Branded 20's
(cont'd)

Bucks FF KSF
 Bucks LT KSF

Third Price Point

Pyramid KS NF
 Pyramid FF KSF
 Pyramid FF KSF Men
 Pyramid LT KSF
 Pyramid FF 100
 Pyramid FF 100 Men
 Pyramid LT 100
 Pyramid Lt 100 Men
 Pyramid ULT LT 100
 Montclair KSF (PV)
 Montclair Lt KSF (PV)
 Montclair Lt KSF Men
 (PV)
 Montclair 100 (PV)
 Montclair Lt 100 (PV)
 Montclair Lt 100 Men
 (PV)
 Bristol Lt KSF
 Bristol Lt KSF Men
 Bristol Lt 100
 Bristol Lt 100 Men

Mid-Price 20's

Stride KSF
 Stride 100
 Stride 100 Men

Mid-Price 20's (Cont'd.)

Stride Dlx Lt KSF
 Stride Dlx Lt 100
 Stride Dlx Lt 100 Mn

Lower Price 30's

L + M Lights 100 (30)

Lower Price 25's

Players Lt KSF (25)
 Players Lt KSF Men (25)
 Players Lt 100 (25)
 Players Lt 100 Men (25)
 Players Lt KSF 250
 Players Lt KSF Men 250
 Players Lt 100 250
 Players Lt 100 Men 250
 Richland KSF 225
 Richland KSF 250
 Richland KSF Men 225
 Richland KSF Men 250
 Richland Lights KSF 250
 Richland 100 250
 Richland 100 Men
 Richland Lights 100 250

25's SEGMENTLower Price 25's

Century KSF
 Century Lights KSF
 Century 100

Lower Price 25's (Cont'd.)Standard Price 25's

Century Lights 100
 Century Lights 100 Men
 Kim 95 Box (25)
 Kim 95 Men Box (25)
 Richland KSF 225
 Richland KSF 250
 Richland KSF Men 225
 Richland KSF Men 250
 Richland Lights KSF 250
 Richland 100 250
 Richland 100 Men
 Richland Lights 100 250
 Century KSF
 Century Lights KSF
 Century 100
 Century Lights 100
 Century Lights 100 Men
 Players Lt KSF (25)
 Players Lt KSF Men (25)
 Players Lt 100 (25)
 Players Lt 100 Men (25)
 Players Lt KSF 250
 Players Lt KSF Men 250
 Players Lt 100 250
 Players Lt 100 Men 250
 Kim 95 Box (25)
 Kim 95 Men Box (25)

Marlboro KSF (25)
 Marlboro Lights KSF (25)
 Newport KSF Men (25)
 Newport 100 Men (25)
 Pall Mall KS NF (25)
 Kool KSF Men (25)
 Kool Mild KSF Men (25)

[In Evidence 2/2/90]

CIGARETTE MARKET SHARES

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF	NOV. 1989	SHARE DIF	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF
INDUSTRY VOLUME - ANN. RATE	521.1		684.5		613.5		616.4		531.3		523.6	
COMPANY												
PHILIP MORRIS	41.93	2.62	43.36	10.93	42.23	1.98	41.38	1.99	43.30	3.55	41.93	2.62
REYNOLDS	28.54	-3.23	20.75	-16.60	27.29	-3.18	26.39	-3.74	26.42	-5.19	28.54	-3.23
BROWN + WILLIAMSON	11.36	0.41	17.57	4.19	11.58	0.59	13.50	1.64	12.32	1.27	11.36	0.41
LORILLARD	7.91	-0.28	9.65	0.05	8.48	0.08	8.85	-0.69	7.72	-0.45	7.91	-0.28
AMERICAN	6.99	0.04	5.62	0.92	7.00	0.14	6.52	0.24	6.88	0.17	6.99	0.04
LIGGETT + MYERS	3.25	0.45	3.03	0.51	3.39	0.39	3.33	0.55	3.35	0.64	3.25	0.45
ALL OTHER COMPANIES	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00
SELECTED BRANDS												
BARCLAY	0.29	-0.04	0.43	0.01	0.32	-0.03	0.35	-0.03	0.30	-0.02	0.29	-0.04
BELAIR	0.48	0.00	0.70	0.12	0.53	0.05	0.60	0.06	0.53	0.06	0.48	0.00
CAPRI	0.57	0.07	0.83	0.17	0.59	0.00	0.72	0.12	0.66	0.10	0.57	0.07
GENERIC (B+W)	1.14	-0.21	1.38	-0.28	1.04	-0.27	1.17	-0.31	1.14	-0.22	1.14	-0.21
KOOL	5.96	-0.07	10.02	2.30	6.07	0.01	7.26	0.67	6.64	0.48	5.96	-0.07
RALEIGH	0.65	-0.07	0.93	0.03	0.67	-0.06	0.74	-0.07	0.67	-0.04	0.65	-0.07
RICHLAND 20	0.81	0.27	1.14	0.42	0.85	0.22	0.97	0.35	0.89	0.27	0.81	0.27
RICHLAND 25	0.16	-0.13	0.19	-0.08	0.15	-0.05	0.16	-0.07	0.15	-0.06	0.16	-0.13
VICEROY	1.29	0.64	1.93	1.53	1.35	0.77	1.52	0.95	1.32	0.75	1.29	0.64

[In Evidence 2/2/90]

CIGARETTE MARKET SHARES

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF	NOV. 1989	SHARE DIF	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF
SEGMENTS												
FLAVOR:...												
MENTHOL	27.20	-0.38	30.45	-0.75	27.44	0.22	28.62	-0.10	27.40	-0.15	27.20	-0.38
NON- MENTHOL	72.78	0.38	69.53	0.75	72.54	-0.22	71.36	0.10	72.57	0.15	72.78	0.38
LENGTH:...												
80-85MM	57.09	-0.01	58.70	1.33	57.07	0.07	57.36	0.07	57.27	0.01	57.09	-0.01
100MM	38.65	0.27	37.87	-0.06	38.75	0.29	38.61	0.34	38.65	0.42	38.65	0.27
100+MM	2.45	0.01	2.05	-0.38	2.44	-0.07	2.34	-0.11	2.37	-0.06	2.45	0.01
70-72MM	1.80	-0.27	1.36	-0.88	1.72	-0.29	1.67	-0.29	1.68	-0.37	1.80	-0.27
FILTRATION:...												
FILTER	95.67	0.39	96.49	0.71	95.76	0.45	96.00	0.45	95.81	0.41	95.67	0.39
NON-FILTER	4.30	-0.39	3.49	-0.71	4.22	-0.45	3.98	-0.45	4.17	-0.41	4.30	-0.39

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

[illegible]

[illegible]

COMPANY SHARE OF MARKET - SHARE OF SEGMENT
SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

[illegible]

[In Evidence 2/2/90]

COMPANY SHARE OF MARKET - SHARE OF SEGMENT
 SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
 TOTAL UNITED STATES

	..... SHARE OF MARKET .....						..... SHARE OF SEGMENT					
	YEAR TO DATE		3 MONTH MVG		12 MONTH MVG		YEAR TO DATE		3 MONTH MVG.		12 MONTH MVG.	
	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE
	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF
VALUE 25'S:												
INDUSTRY	0.89	-0.31	0.82	-0.30	0.89	-0.31	100.00		100.00		100.00	
AMERICAN	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
BROWN +												
WILLIAMSON	0.16	-0.13	0.16	-0.07	0.16	-0.13	17.63	-6.58	19.97	-0.77	17.63	-6.58
LIGGETT +												
MYERS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
LORILLARD	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
PHILIP MORRIS	0.18	-0.06	0.16	-0.07	0.18	-0.06	20.36	0.34	19.45	-1.18	20.36	0.34
REYNOLDS	0.55	-0.12	0.50	-0.15	0.55	-0.12	62.01	6.24	60.58	1.95	62.01	6.24

RANK BASED ON THREE MONTH SHARE

RANK BASED ON THREE MONTH SHARE

BRAND FAMILIES OVER 1% SHARE OF MARKET

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC.	SHARE	DEC.	SHARE	NOV.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE
	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF
MARLBORO	26.36	1.47	27.89	7.79	26.48	1.12	26.07	1.63	27.34	2.18	26.36	1.47
WINSTON	9.01	-1.74	6.56	-6.50	8.42	-1.75	8.24	-1.88	8.20	-2.40	9.01	-1.74
KOOL	5.96	-0.07	10.02	2.30	6.07	0.01	7.26	0.67	6.64	0.48	5.96	-0.07
SALEM	6.24	-1.03	4.50	-4.26	5.88	-1.13	5.71	-1.16	5.68	-1.45	6.24	-1.03
NEWPORT	4.65	0.26	5.91	0.64	5.02	0.64	5.30	0.04	4.61	0.10	4.65	0.26
B + H	3.88	-0.09	3.83	0.64	3.90	-0.09	3.75	-0.29	3.92	-0.01	3.88	-0.09
CAMEL	3.86	-0.47	2.83	-2.33	3.69	-0.62	3.65	-0.69	3.64	-0.78	3.86	-0.47
MERIT	3.84	0.01	3.75	0.67	3.80	-0.15	3.64	-0.24	3.88	0.10	3.84	0.01
DORAL	3.60	0.25	2.89	-0.63	3.64	0.65	3.48	0.65	3.42	0.04	3.60	0.25
VIRGINIA												
SLIMS	3.16	0.14	3.10	0.67	3.32	0.19	3.20	0.13	3.33	0.32	3.16	0.14
PALL MALL	2.66	-0.23	2.11	0.18	2.72	-0.09	2.41	-0.17	2.63	-0.12	2.66	-0.23
CAMBRIDGE	2.27	0.52	2.22	0.56	2.29	0.32	2.33	0.38	2.39	0.41	2.27	0.52
VANTAGE	2.53	-0.43	1.79	-1.76	2.42	-0.47	2.32	-0.51	2.34	-0.59	2.53	-0.43
KENT	2.06	-0.35	2.37	-0.42	2.18	-0.42	2.23	-0.52	1.95	-0.38	2.06	-0.35
CARLTON	1.72	0.00	1.42	0.25	1.68	-0.01	1.60	0.06	1.63	-0.02	1.72	0.00
VICEROY	1.29	0.64	1.93	1.53	1.35	0.77	1.52	0.95	1.32	0.75	1.29	0.64
GENERIC (BW)	1.14	-0.21	1.38	-0.28	1.04	-0.27	1.17	-0.31	1.14	-0.22	1.14	-0.21
RICHLAND	0.97	0.14	1.33	0.34	1.00	0.17	1.14	0.28	1.04	0.22	0.97	0.14
PYRAMID	0.86	0.86	1.05	1.04	1.11	1.11	1.10	1.10	1.08	1.08	0.86	0.86
GENERIC (LIG)	1.22	-0.42	0.92	-0.36	1.05	-0.35	1.04	-0.36	1.11	-0.37	1.22	-0.42
MORE	1.07	-0.08	0.70	-0.62	1.01	-0.09	0.95	-0.16	0.97	-0.15	1.07	-0.08
TRUE	0.85	-0.12	1.00	-0.12	0.92	-0.11	0.95	-0.15	0.82	-0.13	0.85	-0.12
NOW	0.97	-0.05	0.69	-0.40	0.95	-0.07	0.90	-0.12	0.92	-0.10	0.97	-0.05

[In Evidence 2/2/90]

RANK BASED ON THREE MONTH SHARE

RANK BASED ON THREE MONTH SHARE

BRAND FAMILIES OVER 1% SHARE OF MARKET

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
 TOTAL UNITED STATES -

	YEAR TO DATE DEC. 1989	SHARE DIF	CURRENT MO. DEC. 1989	SHARE DIF	PREVIOUS MO. NOV. 1989	SHARE DIF	3 MONTH MVG. DEC. 1989	SHARE DIF	6 MONTH MVG. DEC. 1989	SHARE DIF	12 MONTH MVG. DEC. 1989	SHARE DIF
ALL OTHER												
BRANDS WITH SHARES LESS THAN 1.00%	9.82	0.99	9.81	1.06	10.07	0.64	10.06	0.68	9.98	1.02	9.82	0.99

COMPANY/BRAND RANKED ON THREE MONTH SHARE

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

[illegible]

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989

TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF	NOV. 1989	SHARE DIF	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF
B + H	3.88	-0.09	3.83	0.64	3.90	-0.09	3.75	-0.29	3.92	-0.01	3.88	-0.09
100 B	0.12	0.00	0.12	0.02	0.12	0.00	0.11	0.00	0.12	0.00	0.12	0.00
100	0.70	-0.03	0.69	0.10	0.69	-0.02	0.67	-0.07	0.70	-0.02	0.70	-0.03
100 M B	0.08	0.00	0.08	0.02	0.08	0.00	0.08	0.00	0.08	0.00	0.08	0.00
100 M	0.81	-0.02	0.79	0.13	0.81	-0.02	0.77	-0.06	0.81	-0.01	0.81	-0.02
MULTI-												
FILTER KSF	0.03	0.00	0.03	0.00	0.03	0.00	0.03	-0.01	0.03	0.00	0.03	0.00
KSF B	0.01	0.00	0.01	0.00	0.01	0.00	0.01	0.00	0.01	0.00	0.01	0.00
LT 100												
B (NEW)	0.06	0.00	0.05	0.01	0.06	0.00	0.05	0.00	0.05	0.00	0.06	0.00
LT 100	0.50	-0.02	0.49	0.08	0.50	-0.02	0.48	-0.05	0.50	-0.01	0.50	-0.02
DLX LT 100 B	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
CLASSIC LT												
100 B	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
MULTI-												
FILTER KSF M	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
LT 100 M B												
(NEW)	0.05	0.00	0.05	0.00	0.05	0.00	0.05	0.00	0.05	0.00	0.05	0.00
LT 100 M	0.44	-0.01	0.43	0.07	0.44	-0.01	0.43	-0.04	0.45	0.00	0.44	-0.01
DLX LT 100 M B	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
CLASSIC LT												
100 M B	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
70 FLT B	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
DLX ULT												
100 B	0.64	-0.01	0.64	0.12	0.65	-0.02	0.62	-0.04	0.65	0.01	0.64	-0.01
DLX ULT												
100 M B	0.46	0.01	0.46	0.09	0.46	0.00	0.45	-0.02	0.47	0.02	0.46	0.01

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989

TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC.	SHARE	DEC.	SHARE	NOV.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE
	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF
MERIT	3.84	0.01	3.75	0.67	3.80	-0.15	3.64	-0.24	3.88	0.10	3.84	0.01
DE-NIC KSF	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
KSF B	0.27	0.01	0.27	0.05	0.27	0.00	0.26	-0.01	0.28	0.01	0.27	0.01
KSF	0.94	-0.07	0.92	0.12	0.91	-0.12	0.88	-0.13	0.94	-0.06	0.94	-0.07
100	0.73	-0.04	0.70	0.09	0.71	-0.07	0.68	-0.09	0.72	-0.04	0.73	-0.04
DE-NIC KSF M	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
KSF M	0.15	-0.01	0.14	0.01	0.14	-0.02	0.14	-0.02	0.14	-0.01	0.15	-0.01
100 M	0.13	-0.01	0.12	0.01	0.13	-0.01	0.12	-0.02	0.13	0.00	0.13	-0.01
DE-NIC												
ULT KSF	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
ULT KSF B	0.14	0.03	0.14	0.05	0.15	0.03	0.14	0.03	0.15	0.05	0.14	0.03
ULT KSF	0.64	0.05	0.64	0.15	0.64	0.02	0.61	0.00	0.65	0.06	0.64	0.05
ULT 100 B	0.09	0.00	0.08	0.02	0.09	0.01	0.08	0.01	0.09	0.02	0.09	0.00
ULT 100	0.49	0.04	0.49	0.12	0.49	0.01	0.47	0.00	0.50	0.05	0.49	0.04
DE-NIC ULT												
KSF M	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
ULT KSF M	0.14	0.01	0.13	0.03	0.14	0.01	0.13	0.00	0.14	0.01	0.14	0.01
ULT 100 M	0.12	0.01	0.12	0.02	0.12	0.00	0.12	0.00	0.12	0.01	0.12	0.01
VIRGINIA												
SLIMS	3.16	0.14	3.10	0.67	3.32	0.19	3.20	0.13	3.33	0.32	3.16	0.14
100	0.51	0.00	0.51	0.09	0.51	-0.01	0.49	-0.03	0.52	0.01	0.51	0.00
LT 100 B	0.48	-0.01	0.46	0.07	0.47	-0.04	0.44	-0.05	0.47	-0.01	0.48	-0.01
LT 120 B	0.32	0.02	0.32	0.07	0.33	0.01	0.31	0.00	0.33	0.02	0.32	0.02
100 M	0.43	-0.01	0.43	0.07	0.43	-0.01	0.41	-0.03	0.43	0.00	0.43	-0.01
LT 100 M B	0.53	-0.01	0.52	0.08	0.52	-0.05	0.50	-0.06	0.53	-0.01	0.53	-0.01
LT 120 M B	0.24	0.00	0.24	0.04	0.24	0.00	0.23	-0.01	0.24	0.01	0.24	0.00
ULT 100 B	0.28	0.01	0.27	0.06	0.29	0.01	0.27	0.00	0.29	0.02	0.28	0.01
SSLM 100 B	0.07	0.07	0.07	0.07	0.13	0.13	0.16	0.16	0.14	0.14	0.07	0.07
ULT 100 M B	0.24	0.01	0.23	0.05	0.24	0.01	0.23	0.00	0.25	0.02	0.24	0.01
SSLM 100 M B	0.06	0.06	0.06	0.06	0.15	0.15	0.15	0.15	0.13	0.13	0.06	0.06

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE COMPANY/BRAND RANKED ON THREE MONTH SHARE
 BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
 TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF	NOV. 1989	SHARE DIF	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF	DEC. 1989	SHARE DIF
CAMBRIDGE	2.27	0.52	2.22	0.56	2.29	0.32	2.33	0.38	2.39	0.41	2.27	0.52
FF KSF	0.26	0.08	0.26	0.07	0.27	0.06	0.28	0.06	0.28	0.07	0.26	0.08
FF 100	0.34	0.11	0.34	0.11	0.35	0.08	0.36	0.09	0.37	0.10	0.34	0.11
LT KSF	0.36	0.07	0.35	0.08	0.36	0.03	0.36	0.05	0.38	0.05	0.36	0.07
LT 100	0.52	0.11	0.51	0.14	0.52	0.07	0.53	0.08	0.55	0.09	0.52	0.11
LT KSF M	0.13	0.01	0.12	0.01	0.13	-0.01	0.13	0.00	0.13	-0.01	0.13	0.01
LT 100 M	0.29	0.05	0.28	0.05	0.30	0.02	0.30	0.02	0.30	0.03	0.29	0.05
KSF B	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
KSF	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
100 (PV)	0.36	0.09	0.36	0.11	0.36	0.06	0.37	0.08	0.38	0.08	0.36	0.09
100	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
PARLIAMENT	0.89	0.02	0.89	0.18	0.88	0.02	0.85	-0.02	0.90	0.03	0.89	0.02
LT 100	0.36	0.00	0.35	0.06	0.36	0.01	0.34	-0.02	0.36	0.01	0.36	0.00
LT KSF B	0.34	0.03	0.36	0.10	0.34	0.03	0.33	0.02	0.35	0.03	0.34	0.03
LT KSF	0.18	-0.01	0.18	0.02	0.19	-0.01	0.18	-0.02	0.18	0.00	0.18	-0.01

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989

TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC.	SHARE	DEC.	SHARE	NOV.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE
	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF
ALPINE	0.62	0.52	0.48	-0.11	0.53	0.50	0.54	0.28	0.57	0.41	0.62	0.52
KSF M B PV	0.01	0.01	0.01	-0.01	0.01	0.01	0.01	0.00	0.01	0.00	0.01	0.01
KSF M PV	0.14	0.12	0.10	-0.04	0.11	0.11	0.11	0.05	0.12	0.08	0.14	0.12
KSF M	0.00	-0.02	0.00	0.00	0.00	-0.01	0.00	-0.01	0.00	-0.01	0.00	-0.02
100 M PV	0.15	0.13	0.12	-0.02	0.13	0.12	0.13	0.07	0.14	0.11	0.15	0.13
LT KSF												
M B PV	0.01	0.01	0.01	-0.01	0.00	0.00	0.01	0.00	0.01	0.00	0.01	0.01
LT KSF M PV	0.13	0.11	0.10	-0.04	0.11	0.11	0.11	0.05	0.12	0.08	0.13	0.11
LT 100 M PV	0.18	0.16	0.15	0.02	0.17	0.16	0.17	0.11	0.18	0.15	0.18	0.16
GENERIC (PM)	0.32	0.07	0.30	0.12	0.49	0.17	0.37	0.10	0.34	0.09	0.32	0.07
NF KS	0.01	0.01	0.02	0.01	0.01	0.01	0.02	0.01	0.01	0.01	0.01	0.01
FF KSF	0.04	0.01	0.04	0.01	0.07	0.03	0.05	0.02	0.04	0.01	0.04	0.01
FF 100	0.04	0.01	0.03	0.01	0.07	0.02	0.05	0.01	0.05	0.01	0.04	0.01
LT KSF B	0.01	0.00	0.02	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.00
LT KSF	0.04	0.01	0.03	0.01	0.07	0.03	0.04	0.01	0.04	0.01	0.04	0.01
LT 100	0.07	0.02	0.06	0.02	0.11	0.05	0.08	0.03	0.07	0.02	0.07	0.02
LT KSF M	0.02	0.00	0.01	0.00	0.02	0.01	0.02	0.00	0.02	0.00	0.02	0.00
LT 100 M	0.03	0.00	0.03	0.01	0.04	0.01	0.03	0.00	0.03	0.00	0.03	0.00
ULT KSF	0.01	0.00	0.01	0.00	0.02	0.00	0.01	0.00	0.01	0.00	0.01	0.00
ULT 100	0.05	0.01	0.05	0.02	0.06	0.01	0.05	0.01	0.05	0.01	0.05	0.01

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC.	SHARE	DEC.	SHARE	NOV.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE
	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF
PLAYERS	0.25	-0.07	0.23	-0.02	0.24	-0.08	0.23	-0.09	0.24	-0.07	0.25	-0.07
70 NF B	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
KSF B	0.02	-0.01	0.02	0.00	0.02	-0.01	0.02	-0.01	0.02	0.00	0.02	-0.01
100 B	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00
LT KSF 250	0.03	-0.01	0.03	-0.01	0.03	-0.02	0.03	-0.02	0.03	-0.02	0.03	-0.01
LT KSF (25)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
LT 100 250	0.09	-0.02	0.08	-0.01	0.08	-0.02	0.08	-0.03	0.08	-0.03	0.09	-0.02
LT 100 (25)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
KSF M B	0.01	0.00	0.01	0.00	0.01	0.00	0.01	0.00	0.01	0.00	0.01	0.00
100 M B	0.01	0.00	0.01	0.00	0.01	0.00	0.01	0.00	0.01	0.00	0.01	0.00
LT KSF M 250	0.02	-0.01	0.01	0.00	0.01	-0.01	0.01	-0.01	0.01	-0.01	0.02	-0.01
LT KSF M												
(25)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
LT 100 M 250	0.05	-0.01	0.05	0.00	0.05	-0.02	0.04	-0.02	0.05	-0.01	0.05	-0.01
LT 100 M (25)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
SARATOGA	0.21	-0.02	0.20	0.01	0.21	-0.02	0.20	-0.03	0.21	-0.01	0.21	-0.02
120 B	0.14	-0.01	0.13	0.01	0.14	-0.01	0.14	-0.02	0.14	-0.01	0.14	-0.01
120 M B	0.07	0.00	0.06	0.00	0.07	-0.01	0.07	-0.01	0.07	0.00	0.07	0.00
BRISTOL	0.04	0.04	0.39	0.39	0.00	0.00	0.14	-0.14	0.08	0.08	0.04	0.04
LT KSF PV	0.01	0.01	0.12	0.12	0.00	0.00	0.04	0.04	0.02	0.02	0.01	0.01
LT 100 PV	0.01	0.01	0.12	0.12	0.00	0.00	0.04	0.04	0.02	0.02	0.01	0.01
LT KSF M PV	0.01	0.01	0.08	0.08	0.00	0.00	0.03	0.03	0.02	0.02	0.01	0.01
LT 100 M PV	0.01	0.01	0.08	0.08	0.00	0.00	0.03	0.03	0.02	0.02	0.01	0.01

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989

TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC.	SHARE	DEC.	SHARE	NOV.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE
	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF
RIO	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
KSF M	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
100 M	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
ROTHMANS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
BLUE KSF B	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
RED KSF B	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
ST. MORITZ	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
100	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
100 MEN	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TOTAL												
R J												
REYNOLDS	28.54	-3.23	20.75	-16.60	27.29	-3.18	26.39	-3.74	26.42	-5.19	28.54	-3.23
WINSTON	9.01	-1.74	6.56	-6.50	8.42	-1.75	8.24	-1.88	8.20	-2.40	9.01	-1.74
KSF B	0.41	-0.07	0.30	-0.31	0.41	-0.07	0.39	-0.08	0.39	-0.10	0.41	-0.07
KSF	3.66	-0.78	2.72	-2.74	3.38	-0.82	3.35	-0.81	3.34	-1.03	3.66	-0.78
100	1.30	-0.30	0.93	-1.03	1.20	-0.28	1.18	-0.30	1.16	-0.40	1.30	-0.30
LT KSF B	0.17	-0.01	0.12	-0.05	0.17	0.00	0.16	-0.02	0.17	-0.01	0.17	-0.01
LT KSF	1.68	-0.34	1.22	-1.25	1.55	-0.35	1.53	-0.36	1.52	-0.47	1.68	-0.34
LT 100 B	0.08	-0.01	0.06	-0.03	0.09	0.00	0.08	-0.01	0.09	0.00	0.08	-0.01
LT 100	1.14	-0.20	0.82	-0.81	1.07	-0.20	1.04	-0.22	1.02	-0.29	1.14	-0.20
ULT KSF	0.25	0.01	0.16	-0.05	0.22	0.00	0.21	-0.02	0.21	-0.02	0.25	0.01
ULT 100	0.32	-0.05	0.23	-0.23	0.32	-0.05	0.30	-0.06	0.31	-0.07	0.32	-0.05

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC.	SHARE	DEC.	SHARE	NOV.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE
	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF
SALEM	6.24	-1.03	4.50	-4.26	5.88	-1.13	5.71	-1.16	5.68	-1.45	6.24	-1.03
KSF M	1.40	-0.28	1.03	-1.02	1.31	-0.27	1.29	-0.27	1.28	-0.35	1.40	-0.28
100 M	0.93	-0.20	0.68	-0.71	0.88	-0.20	0.86	-0.20	0.84	-0.27	0.93	-0.20
KSF M B (2)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
LT KSF M	1.46	-0.27	1.05	-1.06	1.36	-0.31	1.32	-0.31	1.32	-0.37	1.46	-0.27
LT 100 M B	0.10	-0.02	0.06	-0.05	0.10	-0.01	0.09	-0.03	0.10	-0.01	0.10	-0.02
LT 100 M	1.13	-0.22	0.81	-0.83	1.05	-0.25	1.02	-0.25	1.02	-0.31	1.13	-0.22
SLIM LT												
100 M B	0.44	-0.02	0.33	-0.25	0.44	-0.03	0.42	-0.03	0.42	-0.05	0.44	-0.02
ULT KSF M	0.31	0.02	0.21	-0.05	0.29	-0.01	0.28	-0.02	0.28	-0.02	0.31	0.02
ULT 100 M	0.46	-0.04	0.34	-0.28	0.45	-0.06	0.43	-0.05	0.42	-0.08	0.46	-0.04
CAMEL	3.86	-0.47	2.83	-2.33	3.69	-0.62	3.65	-0.69	3.64	-0.78	3.86	-0.47
70 NF	1.21	-0.24	0.89	-0.89	1.13	-0.27	1.12	-0.26	1.11	-0.34	1.21	-0.24
KSF BOX (2)	0.27	0.04	0.22	-0.03	0.27	0.01	0.27	-0.05	0.27	-0.02	0.27	0.04
KSF	0.93	-0.18	0.66	-0.66	0.86	-0.22	0.87	-0.22	0.87	-0.25	0.93	-0.18
FLT 100	0.06	0.00	0.04	-0.02	0.07	0.00	0.06	-0.01	0.06	0.00	0.06	0.00
LT KSF B	0.24	0.04	0.20	0.01	0.25	0.04	0.24	0.03	0.24	0.04	0.24	0.04
LT KSF B	0.90	-0.08	0.64	-0.54	0.84	-0.14	0.84	-0.13	0.83	-0.16	0.90	-0.08
LT 100	0.26	-0.05	0.18	-0.21	0.26	-0.04	0.25	-0.05	0.25	-0.05	0.26	-0.05

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989

TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC.	SHARE	DEC.	SHARE	NOV.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE
	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF
CENTURY	0.55	-0.12	0.35	-0.26	0.57	-0.05	0.50	-0.16	0.55	-0.09	0.55	-0.12
100	0.17	-0.03	0.11	-0.07	0.17	-0.01	0.15	-0.04	0.17	-0.02	0.17	-0.03
KSF	0.05	-0.02	0.03	-0.05	0.06	-0.01	0.05	-0.02	0.05	-0.01	0.05	-0.02
LT KSF	0.06	-0.03	0.04	-0.05	0.07	-0.01	0.06	-0.03	0.06	-0.02	0.06	-0.03
LT 100	0.24	-0.04	0.16	-0.08	0.23	-0.02	0.21	-0.05	0.23	-0.03	0.24	-0.04
LT 100 M	0.03	-0.01	0.02	-0.02	0.03	0.00	0.03	-0.01	0.03	-0.01	0.03	-0.01
MAGNA	0.52	0.40	0.26	0.11	0.46	0.28	0.42	0.23	0.46	0.26	0.52	0.40
FF KSF B (PV)	0.14	0.10	0.06	0.02	0.12	0.06	0.11	0.04	0.12	0.05	0.14	0.10
FF KSF B	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
FF KSF (PV)	0.16	0.12	0.09	0.04	0.15	0.08	0.14	0.07	0.16	0.08	0.16	0.12
FF KSF	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
LT KSF B												
(PV)	0.10	0.10	0.04	0.04	0.08	0.08	0.07	0.07	0.08	0.08	0.10	0.10
LT KSF (PV)	0.12	0.09	0.06	0.01	0.11	0.05	0.10	0.04	0.11	0.05	0.12	0.09
LT KSF	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
GENERIC (RJR)	0.08	0.05	0.11	0.09	0.13	0.03	0.12	0.07	0.11	0.07	0.08	0.05
FF KSF	0.01	0.01	0.01	0.01	0.02	0.00	0.02	0.01	0.01	0.01	0.01	0.01
FF 100	0.01	0.01	0.02	0.01	0.02	0.01	0.02	0.01	0.02	0.01	0.01	0.01
LT KSF	0.01	0.01	0.01	0.01	0.02	0.00	0.02	0.01	0.01	0.01	0.01	0.01
LT 100	0.01	0.01	0.02	0.02	0.02	0.01	0.02	0.01	0.02	0.01	0.01	0.01
LT KSF M	0.01	0.00	0.01	0.01	0.01	0.00	0.01	0.00	0.01	0.00	0.01	0.00
LT 100 M	0.01	0.01	0.01	0.01	0.02	0.00	0.01	0.01	0.01	0.01	0.01	0.01
ULT KSF	0.00	0.00	0.00	0.00	0.01	0.01	0.01	0.01	0.00	0.00	0.00	0.00
ULT 100	0.01	0.01	0.02	0.01	0.02	0.01	0.02	0.01	0.02	0.01	0.01	0.01

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989

TOTAL UNITED STATES

[illegible]

[In Evidence 2/2/90]

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COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989

TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC.	SHARE	DEC.	SHARE	NOV.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE
	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF
GENERIC (BW)	1.14	-0.21	1.38	-0.28	1.04	-0.27	1.17	-0.31	1.14	-0.22	1.14	-0.21
70 NF	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
KS NF	0.09	0.00	0.12	0.02	0.08	0.00	0.09	0.00	0.09	0.00	0.09	0.00
FF KSF	0.13	-0.02	0.16	-0.02	0.13	-0.01	0.14	-0.02	0.13	-0.01	0.13	-0.02
FF 100	0.13	-0.03	0.17	-0.03	0.13	-0.03	0.14	-0.03	0.14	-0.02	0.13	-0.03
FF KSF M	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00
FF 100 M	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00
LT KSF	0.16	-0.05	0.18	-0.08	0.13	-0.07	0.15	-0.08	0.16	-0.06	0.16	-0.05
LT 100	0.19	-0.05	0.22	-0.08	0.17	-0.07	0.19	-0.08	0.19	-0.06	0.19	-0.05
LT KSF M	0.08	-0.02	0.09	-0.03	0.08	-0.02	0.08	-0.03	0.08	-0.02	0.08	-0.02
LT 100 M	0.12	-0.03	0.14	-0.05	0.11	-0.04	0.12	-0.04	0.12	-0.03	0.12	-0.03
ULT KSF M	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
ULT KSF	0.07	-0.01	0.09	-0.01	0.07	-0.01	0.08	-0.01	0.07	-0.01	0.07	-0.01
ULT 100	0.14	-0.02	0.16	-0.02	0.12	-0.02	0.14	-0.02	0.14	-0.02	0.14	-0.02
ULT 100 M	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
RICHLAND	0.97	0.14	1.33	0.34	1.00	0.17	1.14	0.28	1.04	0.22	0.97	0.14
FF KSF	0.20	0.08	0.28	0.11	0.20	0.05	0.24	0.08	0.22	0.07	0.20	0.08
KSF 250	0.04	-0.04	0.05	-0.02	0.04	-0.01	0.04	-0.02	0.04	-0.02	0.04	-0.04
KSF 225	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
FF 100	0.22	0.09	0.32	0.12	0.23	0.06	0.27	0.10	0.24	0.08	0.22	0.09
100 250	0.05	-0.04	0.07	-0.02	0.05	-0.01	0.06	-0.02	0.06	-0.02	0.05	-0.04
FF KSF M	0.08	0.02	0.11	0.04	0.09	0.02	0.10	0.04	0.09	0.03	0.08	0.02
KSF M 250	0.03	-0.02	0.03	-0.01	0.03	-0.01	0.03	-0.01	0.03	-0.01	0.03	-0.02
FF 100 M	0.08	0.02	0.12	0.04	0.09	0.03	0.10	0.04	0.09	0.03	0.08	0.02
100 M 250	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
LT KSF	0.10	0.02	0.13	0.04	0.10	0.03	0.11	0.04	0.11	0.03	0.10	0.02
LT KSF 250	0.01	-0.01	0.01	-0.01	0.01	-0.01	0.01	-0.01	0.01	-0.01	0.01	-0.01
LT 100	0.13	0.04	0.19	0.06	0.14	0.03	0.16	0.05	0.14	0.04	0.13	0.04
LT 100 250	0.02	-0.02	0.03	-0.02	0.02	-0.01	0.02	-0.01	0.02	-0.01	0.02	-0.02

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

	YEAR TO DATE		CURRENT MO.		PREVIOUS MO.		3 MONTH MVG.		6 MONTH MVG.		12 MONTH MVG.	
	DEC.	SHARE	DEC.	SHARE	NOV.	SHARE	DEC.	SHARE	DEC.	SHARE	DEC.	SHARE
	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF	1989	DIF
RALEIGH	0.65	-0.07	0.93	0.03	0.67	-0.06	0.74	-0.07	0.67	-0.04	0.65	-0.07
KS NF	0.05	-0.01	0.06	0.00	0.05	-0.01	0.05	-0.01	0.05	-0.01	0.05	-0.01
KSF	0.27	-0.03	0.39	0.02	0.28	-0.01	0.31	-0.02	0.28	-0.01	0.27	-0.03
100	0.21	-0.02	0.30	0.02	0.21	-0.02	0.24	-0.02	0.22	-0.01	0.21	-0.02
LT KSF	0.06	0.00	0.08	0.00	0.06	-0.01	0.07	-0.01	0.06	-0.01	0.06	0.00
LT 100	0.06	-0.01	0.09	-0.01	0.07	-0.01	0.07	-0.01	0.06	-0.01	0.06	-0.01
CAPRI	0.57	0.07	0.83	0.17	0.59	0.00	0.72	0.12	0.66	0.10	0.57	0.07
120 B	0.01	0.01	0.01	0.01	0.01	0.01	0.02	0.01	0.01	0.01	0.01	0.01
97 B	0.30	0.04	0.43	0.08	0.31	-0.01	0.37	0.06	0.35	0.05	0.30	0.04
120 M B	0.01	0.01	0.01	0.01	0.01	0.01	0.02	0.01	0.01	0.01	0.01	0.01
97 M B	0.26	0.03	0.37	0.06	0.26	-0.01	0.32	0.04	0.30	0.04	0.26	0.03

COMPANY/BRAND RANKED ON THREE MONTH SHARE

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989

TOTAL UNITED STATES

[illegible]

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

	YEAR TO DATE DEC. 1989	SHARE DIF	CURRENT MO. DEC. 1989	SHARE DIF	PREVIOUS MO. NOV. 1989	SHARE DIF	3 MONTH MVG. DEC. 1989	SHARE DIF	6 MONTH MVG. DEC. 1989	SHARE DIF	12 MONTH MVG. DEC. 1989	SHARE DIF
TALL	0.03	0.00	0.02	0.00	0.03	0.00	0.03	0.00	0.03	0.00	0.03	0.00
120	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00	0.02	0.00
120 M	0.01	0.00	0.00	0.00	0.01	0.00	0.00	0.00	0.00	0.00	0.01	0.00
MISTY	0.00	0.00	0.01	0.01	0.00	0.00	0.01	0.01	0.00	0.00	0.00	0.00
SLIM LT												
100 B PV	0.00	0.00	0.01	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
SLIM LT												
100 M B PV	0.00	0.00	0.01	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
BULL												
DURHAM KSF	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
HALF +												
HALF KSF	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
ICEBERG 100												
M	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
OTHER												
AMERICAN												
BRANDS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TOTAL												
LIGGETT												
AND MYERS	3.25	0.45	3.03	0.51	3.39	0.39	3.33	0.55	3.35	0.64	3.25	0.45

COMPANY/BRAND RANKED ON THREE MONTH SHARE

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

[illegible]

[In Evidence 2/2/90]

COMPANY/BRAND RANKED ON THREE MONTH SHARE

COMPANY/BRAND RANKED ON THREE MONTH SHARE

BRAND SHARE ANALYSIS

SHARE AND CHANGE VERSUS YEAR AGO - DECEMBER, 1989
TOTAL UNITED STATES

[illegible]

[In Evidence 2/2/90]

Annual Report 1989

Liggett Group Inc.

* * *

Positioned to Meet the Challenges

At Liggett, we are known for our strategic innovation. We continue to direct our creative abilities toward product development and customer support. Our sales force is structured to support our customers' desires for tailored, individualized programs and to increase our visibility in the marketplace.

Our manufacturing operations are expertly managed in the flexible manner necessary to meet ever-changing market demands and ensure quality and efficiency. Thus, we have the ability to rapidly bring a new product to the marketplace at a competitive price.

We made a number of strategic moves to position ourselves to take advantage of the opportunities available in various market niches. We will continue our strategy to maximize the long-term profitability of our full-price, branded products with special emphasis on our Eve brand. We will also continue to have a strong focus on price/value brands.

Price/value is a growing portion of the cigarette business and rivalry for market share of the segment is intense. As the prices of price/value cigarettes have been moving closer to those of full-price brands, consumers have been expressing a desire for image-oriented, low-price brands instead of the original black-and-white generic cigarette.

Liggett created the low-price cigarette in 1980 when it introduced its generic cigarettes. In fiscal 1989 we introduced

several new branded price/value products such as Chesterfield Filter Lights and Savvy as well as Pyramid, a new extra low price category. We believe these brands are indicative of Liggett's strategic innovation.

International Opportunities

The Far East is proving to be a viable expansion market for Liggett's products. Liggett was the first company to introduce

[Photo and Caption deleted in Printing]

* * *

tomers' business objectives and are able to give their accounts the kind of personal service and attention that it takes to promote and sell our products. Hundreds of service merchandisers across the country assure that our support programs are implemented on time and in the most effective manner.

Products

In 1980 Liggett introduced the generic cigarette which spawned a category that has evolved into the price/value segment. We delivered quality and value in our generic and private label cigarettes and the consumer responded. This market segment, including "branded" price/value, private label and value-added products with 25 or 30 cigarettes for the price of the traditional 20, has become the fastest growing segment of the industry.

According to "The Maxwell Consumer Report," a widely recognized industry trade publication, in 1984 price/value products accounted for approximately 6 percent of industry

sales. That market share grew to 11 percent in 1988 and some project it to reach nearly 17 percent by 1991.

We continue to emphasize branded price/value cigarettes and to work with our private label customers to upgrade their private label brands' images. Many of our customers have responded to more appealing packaging.

As pressure for higher taxation increases and as prices increase, we will continue to position ourselves in this category which offers significant appeal and choice to consumers. We are committed to this segment and it is one of our key areas of focus.

[Photo Deleted in Printing]

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Management's Discussion and Analysis

Results of Operations

This discussion should be read in conjunction with the financial statements of Liggett and notes thereto included elsewhere in this report. Net sales and cost of sales both include federal excise taxes.

Fiscal Year Ended March 31, 1989 vs. Fiscal Year Ended March 31, 1988. Net sales were \$500,969,000 for the fiscal year ended March 31, 1989, compared to net sales of \$531,891,000 for the same period one year earlier. The decrease in net sales was due primarily to a 16% decline in unit sales volume of cigarettes partially offset by an 11.4% increase in selling prices. The decrease in cigarette unit sales volume was comprised of a 14% decline in full-price, branded cigarette volume and a 17% decline in price/value cigarette volume. The decline in volume of

Liggett's full-price, branded cigarettes was higher than the decline rate of these brands in recent years, and was attributable to market pressures. Liggett's management anticipates that the volume of the Company's mature full-price brands (Chesterfield, Lark and L&M) will continue to decline. The decline in volume of the price/value cigarettes was due primarily to the accelerated decline in market share of the Company's black & white generic brands. This reflects growing consumer preference for branded products sold at generic prices, as generic prices have increased relative to full-price brands. Liggett's management believes that this trend will continue. The Company's ability to compete effectively in the price/value segment will be heavily dependent upon its success in protecting the distribution of its private label brands and introducing new branded price/value products. In addition, the Company must aggressively pursue its diversification strategy to offset the potential decline in revenue from a continued loss of market share in its cigarette operations. Effective January 1, 1989, Liggett began marketing Fazer confectionery products in accordance with an exclusive licensing agreement with Oy Karl Fazer Ab, a Finland-based confectionery producer. For the three months ended March 31, 1989, net sales for these products amounted to \$1,492,000.

Gross profit as a percent of net sales (excluding federal excise taxes) increased to 66.7% for the fiscal year ended March 31, 1989 from 63.0% for the same period one year earlier. This increase was a result primarily of higher selling prices and improved manufacturing efficiencies that more than offset the loss in sales volume and inflationary cost increases. Selling, general and administrative

expenses increased to 53.8% of net sales (excluding federal excise taxes) for the fiscal year ended March 31, 1989, compared to 48.0% for the same period one year earlier. This increase was primarily due to increased marketing expenses in response to competitor marketing activities, partially offset by a reduction in legal fees. At March 31, 1989, the product liability caseload was the lowest it has been in over three years. This reflects the overall industry situation with fewer cases being filed and many being dismissed or dropped.

Net interest expense was \$396,000 for the fiscal year ended March 31, 1989 compared to \$6,191,000 for the same period one year earlier. This decrease was largely attributable to a reduction of the acquisition indebtedness during the fiscal year ended March 31, 1988 and increased interest income on investments during the current year.

Net income decreased 1.5% to \$30,240,000 for the fiscal year ended March 31, 1989, from \$30,688,000 last year as a result of the decline in cigarette unit sales volume and higher selling, general and admin-

[Chart Omitted in Printing]

[Excerpt Of The Trial Proceedings: Court]

* * *

[p. 1-145] element under Section 2(a) of the – pardon me – I’ve heard Mr. London so much, I keep thinking it’s a Sherman Act case – the Robinson-Patman Act, injury to competition is required as a part of Section 2(a) violation. Plaintiff has maintained from day one, right to the day and right to the end of trial, that the injury to competition will be injury to competition in the cigarette market in the United States. That is where the injury to competition took place, and it’s where the injury to competition was held. That has been plaintiff’s consistent position. Now ---

THE COURT: Everybody agrees, right?

MR. HOGELAND: We were in agreement that that’s where the competitive injury took place. We’ve always said that, they know we’ve always said that, and we are talking about price discrimination. Price discrimination is with respect to generic cigarettes; pricing below cost has been with respect to generic cigarettes. The pricing discrimination, the pricing below cost, is with respect to generic cigarettes. That is a part of a Robinson-Patman violation. Robinson-Patman doesn’t require a relevant market, but competitive injury must take place somewhere, and it takes place in this overall national cigarette market. We have never disagreed with that. Our experts have always said that, and they know it, and we never changed it.

THE COURT: Mr. London, are we in agreement then?

[p. 1-146] MR. LONDON: Well, I think I’m in agreement with what Mr. Hogeland said in the last four minutes. I think I am not the only person in the room that is struggling to reconcile the most recent statement with his next previous statement, which I understood to be almost directly to the contrary when he said, “The relevant market is generic cigarettes.” Now he can’t, Your Honor ---

THE COURT: Okay. Well, I understood it that way, too. So let’s see if we are in agreement, and not talk about who said something 30 minutes being in disagreement – 30 minutes ago.

What I understand Mr. Hogeland is saying is what my limited understanding of the case is about, and what I understood Mr. London to be saying he thought the case was about. Now it did seem, Mr. Hogeland, somewhat different from what Mr. Foster started off saying and that you started off saying. You are contending that you can make out a violation of Robinson-Patman, and have never contended otherwise, that there was any discriminatory pricing in anything but the generic cigarette market. Of course, the intent of it there from Liggett’s theory is for Brown to protect it’s ultra-high profits in the branded market, and that’s ---

MR. HOGELAND: Correct.

THE COURT: And that’s what I’ve understood the [p. 1-147] case, and that’s why we didn’t buy Mr. Michael Robinson’s argument, although well put several weeks ago, on the Cadillacs and cigarettes being sold out of the same – by the same company, or something. We’re talking about cigarettes generally. Now with the lessening

of competition, I understand you to say that Liggett contends there is a lessening of competition in the domestic cigarette market, whether branded or generic, excluding marijuana cigarettes, I assume.

MR. HOGELAND: Yes, sir.

THE COURT: Is that – is everybody happy?

MR. LONDON: Well, I understood Your Honor – I understood Your Honor's question, and I understood Mr. Hogeland's response, and I think certain things flow from that which we don't have to address at this late hour today. We should go on with the trial of the case. Mr. Hogeland's words will be brought back to Your Honor's attention on a number of occasions as the trial moves on.

Thank you, sir.

THE COURT: All right. Well, isn't that what he's been saying all along?

MR. HOGELAND: Yes, indeed, it is.

THE COURT: I know you contend, apparently, and have throughout, before the Magistrate and me, and maybe ultimately correctly, for all I know, that – that's no [p. 1-148] Robinson-Patman violation if you sell at different prices for generics to protect branded is not a violation. But we've crossed that bridge, unless in the next 90 days ---

MR. HOGELAND: Your Honor, before he quotes my language back to me, there is no change in our position, ever, that the injury to competition takes place in the cigarette market. We talk about discrimination, and

we have consistently talked about discrimination as being in the generic market. We talk about predatory pricing and pricing below cost in the generic business, Your Honor, and let me just make sure, before Mr. London quotes it back to me, that there's no more misunderstanding, if there ever was one. Brown and Williamson's expert's report that they filed talked about studying the price/cost relationship, and they say, "We intend to study price and cost data to ascertain whether, and by how much, Brown and Williamson's net prices of generic cigarettes exceeded the average variable cost of producing them." That has been always our position, too, Your Honor, and that is the issue in this case. When we talk about discrimination and below cost pricing, there we are talking about generic cigarettes. We are talking about an injury to competition that happened in the cigarette market, and that has been consistently our position and it will be our position until the end of trial, Your Honor.

MR. LONDON: If Your Honor please, I heard

* * *

[p. 1-151] or so, this is basically what I thought both sides had been doing and trying here for months and years. I don't know what's different, except for the fact both of you still believe in your position.

MR. HOGELAND: There's no difference, Your Honor, except that Mr. London just said – made reference to our claiming some sort of injury in some fragment of the cigarette market. We don't claim that. We never have claimed that. We're claiming injury in the cigarette market, not in some fragment of it. We claim predation and discrimination with respect to generic cigarettes, injury in

the cigarette market, not a fragment of it in the cigarette market, cigarette business, competition in cigarettes has been injured. It's always been our position and will remain our position.

MR. NORWOOD ROBINSON: Judge, let me say one thing. I brought this up, and I want to tell you how it came about, sir.

THE COURT: Mr. Robinson, I'm not keeping a score up here ---

MR. NORWOOD ROBINSON: I know you're not. I know you're not, sir.

THE COURT: --- of black marks or gold stars about who brings up dumb things. I'm sure I'll bring up dumb things before it's over, too. But ---

* * *

[Excerpt Of The Trial Testimony Of K.v.R. Dey]

* * *

[p. 2-127] the price of cigarettes which are sold by the thousands, and also the terms of the sale.

Q What do you mean by terms of the sale?

A Well, if you buy cigarettes and you pay promptly, you get a cash discount. In cigarettes it's three and a quarter percent, 10, 12, 14 days, depending on the particular manufacturer that you are doing business with. In the normal grocery business it's two percent, 10 days.

Q Can you explain to me how that works?

A Well, if you get a shipment of cigarettes and you pay within the 12 day period, you get two percent off, which you take off the bill when you pay it. You get a two percent cash discount as if - like you buy something for cash in some of the stores that you do business, you can get something off for cash.

Q And the terms that you refer to are a part of each manufacturer's price list. Is that correct?

A Yes, sir, it is.

Q What else appears on the manufacturer's price list?

A Well, a list of all the cigarettes that each manufacturer sells, the length or size and the price, and any other information that that particular manufacturer wants to put on there.

Q In 1976 when you went to Liggett and Myers, did the list price for cigarettes vary by manufacturer or by brand?

[p. 2-128] A No. The list price was the same for all lengths of cigarettes. In other words, the 85 or king size cigarette and there's the 100 mm cigarette and they were all priced the same. All the 85's are priced the same and all the 100 mm's were priced the same.

Q What's the difference between the 85 mm and the 100 mm?

A Oh, it's just, what - 15 mm length. One is longer than the other.

MR. HOGELAND: May I approach the witness, Your Honor?

THE COURT: Yes, sir. Any time you want to hand him any documents or exhibits you may do so without asking the Court.

BY MR. HOGELAND:

Q Now, Mr. Dey, I show you what's been marked as Defendant's Exhibit 10,468 and ask if you can tell me what it is?

THE COURT: Is this Plaintiff's Exhibit?

MR. HOGELAND: No, this is a Defendant's Exhibit Number, Your Honor.

THE COURT: Okay.

A This is a 100 mm cigarette, Barclay's brand.

MR. HOGELAND: I offer that into evidence, Your Honor.

THE COURT: All right, gentlemen. We've talked about pre-marking these exhibits. If this is now going to be

* * *

[p. 2-133] THE WITNESS: Brown and Williamson makes the Barclay and Philip Morris makes the Merit.

THE COURT: All right.

BY MR. HOGELAND:

Q Now, Mr. Dey, you testified that the list price for cigarettes was the same for those of the same length. Is it your testimony that the 100mm Barclay and the 100mm Merit had the same list price.

A Yes, sir.

Q And is it your testimony that the king size or 85mm Barclay and the king size or 85mm Merit had the same list price? Is that correct?

A Yes.

Q Can you tell me again, what is the list price?

A The list price is the published price put out by the manufacturers to all direct line accounts.

Q In 1980, Mr. Dey, what was the price of other brands of 100mm cigarettes - as compared with the price of 100mm Barclay and the 100mm Merit?

MR. NORWOOD ROBINSON: Your honor, I object to this. I understand he means list price, which is what he's been asking.

THE COURT: That's what I understand the list price is. Overruled.

A You're asking the list price? How they compared with [p. 2-134] them?

BY MR. HOGELAND:

Q I would like to know what the list price was of other 100mm cigarettes was as compared with the list price of the Barclay 100 and the Merit 100, which you have identified.

A All 100's were priced the same and all 85's were priced the same in the industry.

Q And was that true prior to 1980 also?

A Yes, it was.

Q Since 1976, Mr. Dey, when you joined Liggett and Myers, has the manufacturers' list prices for cigarettes stayed the same?

A No, they have not. They've gone up the average of once a year and most recently, for the past, I would say for the last 8 to 10 years, about twice a year.

Q At Liggett and Myers how do you decide when to increase your list price?

A Well, when we make our particular plan for the year based on the assumptions that we put into that plan, we estimate when we think the industry will go up in price and we plan accordingly to that plan.

Q Does the industry go up in price all at once?

A Usually one of the larger shares, about two or three people, one of them goes up and then within about

two weeks maximum period, the others have all followed.

[p. 2-135] Q Do they always all go up the same amount?

A Generally speaking, yes. That's historically true. They all go up the same amount so there is no advantage.

Q How many cigarette manufacturers are there in the United States?

A Six major manufacturers.

Q What are they? Can you name them for us?

A Philip Morris, who has approximately today, about 40 share of market. R. J. Reynolds - RJR Nabisco, whatever it is called today, is about a 31 - 30 to 31 share ---

Q Let me interrupt you. Explain what you mean by share of market.

A Well, let's take the whole market is 100%. Forty share would be 40% of the market. We use share in place of percents in this case. Brown and Williamson would be about 11% share - 11 share. Then comes American Tobacco and Lorillard ---

MR. NORWOOD ROBINSON: Your Honor, may I inquire if he's talking about now?

THE WITNESS: Yes, sir.

A The American and Lorillard are 7 or 8 share apiece. We're about a 3 share.

Q What are Philip Morris' principal brands, Mr. Dye [sic]?

A Marlboro, Merit, Benson & Hedges, Cambridge are some of them.

* * *

[p. 2-146] stronger effort initially for pack sales rather than carton sales?

A On branded items, yes, we do try to make sure that you get some pack trials so that people can try the cigarette to find out whether they like it or not, and then you try to have them eventually buy a carton. But in order to have somebody switch, because not a lot of people switch in smoking cigarettes historically. So, in order to get them to switch you have to have them probably try the cigarette maybe three times before they might accept a carton. So pack sales are initially important.

Q Was Eagle a cheaper cigarette to manufacture than other brands of cigarettes made by Liggett and Myers?

A No, it was not.

Q Did Liggett and Myers price Eagles so as to make a profit for Liggett and Myers?

A Yes, we did.

Q Was Eagle the same quality cigarette as Liggett and Myers brand of cigarette?

A Yes, it was. Same tobacco.

Q How did Liggett and Myers expect to make a profit selling the same quality cigarette at a lower price?

A Well, the profit in cigarettes or the margin in cigarettes, if you want to call it that, were very sufficient in order to take 50¢ a carton off the price and still be able to market [p. 2-147] it and still make money.

Q You have 50¢ off a price. You found through the Eagle experience was not enough to create a successful new price point? Is that correct?

A Yes, sir. That's correct.

Q At that time in the late '70's, what were the cigarette industry's profits as compared to other businesses you had worked in?

A Well, the profits in the cigarette industry are the best of any industry I've been associated with, very much so.

Q Is that also true today?

A Yes, it is.

Q Are the profits of cigarette manufacturers higher today than they were when you came to the industry?

A Yes, they are.

Q When you took over in 1976, was Liggett and Myers making a profit?

A Yes, we were making a profit. In 1977 when I came in we were making a profit but not a satisfactory one.

Q What was unsatisfactory about it?

A Well, our company at that time, we'd had considerable declines in our business and we had not adjusted

our company to the size business we were, if you will. We had excess assets that we were not using in the day to day operation of

* * *

[p. 2-158] A well, when you look at generic products and the pricing – where we looked at the whole generic category, of course, generic products were priced lower than the private label for the chain. The chain had a private label – Ann Page is an example I used before, and generics were priced below that. It was felt that generic, to be successful, should be about 30% less than branded prices, whereas private label ordinarily about 20% less. In order to make generic successful, they felt you had to have a 30% less differential – price differential at retail. We started out not quite at 30% but we eventually got there.

Q Do I understand your testimony? You and TopCo decided and agreed to a larger differential for generic cigarettes than was the practice for other generic products?

MR. NORWOOD ROBINSON: Object to the leading.

THE COURT: Sustained.

BY MR. HOGELAND:

Q What was the differential for other generic products?

A Well, all generic products had to be about 30% less. We just fit into that.

It wasn't always accomplished.

Q What happened as a result of your selling generic cigarettes to Jewel?

A To TopCo?

Q To TopCo.

* * *

[p. 3-174] A Are you talking about the consumer?

Q I'm asking you what you have previously testified to under oath, sir, and the question – one more time – is whether or not you have testified that, and I quote, "The public has not been denied the benefits of free and open competition in the cigarette industry."

A As I define the word competition, that's correct.

Q Is that what you testified to?

A That's my statement, sir.

Q And have you testified under oath, sir, that there is competition among tobacco manufacturers in branded cigarettes?

A Among manufacturers there is competition as I define it.

Q And did you testify, sir, that it was competition – did you characterize it – this competition – as being intense?

A As I defined competition in getting our products to the retailer and selling it, yes, it is intense.

Q Well, sir, in all of this experience and training and college education and courses you've had, you understand what competition is, don't you?

A I would hope so.

Q Well, you allege, don't you, sir, that my client has injured competition [sic]? That's the basis of your lawsuit, isn't it?

A You've injured competition. I'm competition.

[p. 3-175] Q Yes, sir, but your allegation was – in the complaint, wasn't it, and your testimony is that my client has not – has injured competition. Not a competitor, but injured competition. Isn't that your contention?

MR. HOGELAND: Objection, Your Honor.

THE COURT: Overruled.

THE WITNESS: As I define competition, yes.

BY MR. NORWOOD ROBINSON:

Q Well, what is it that you say that my client has done? What is it he's done in damaging competition?

A The client gave rebates that went to the middle man. I mean Brown and Williamson – excuse me – gave rebates that went to the middle man that were not reflected at retail. Did not give the consumer the benefits of a better bargain. Did not increase the differentials. They went out to control the market. Displace us. They went out to discriminate, to cause people to look to see that they have to buy exclusively from Brown and Williamson to get the best rebate. Put pressures against us. Caused us pain while it didn't cost them as much to do it. The results did not get to the consumer in lower prices and better bargains. And that's why.

Q Have you ever done any of those things at Liggett that you've just talked about?

A Our business is aimed at expanding the category.

* * *

[p. 3-179] the same price that all other manufacturers charged, you said, was a fair and reasonable price for the product.

A As the industry set the standard, yes, sir.

MR. NORWOOD ROBINSON: Your Honor, I object to that answer. If I could get a yes or no. He qualifies it every time I ask it. May I ask it again, sir?

THE COURT: Yes, sir.

BY MR. NORWOOD ROBINSON:

Q I want to know – yes or no – sir, whether or not you say that the price you charged for branded cigarettes, which is the same price you say everybody else charged, was a fair and equitable price for that product to the American consumer.

A It's what the industry set, and based on that it's a fair price.

Q Sir, can you answer my question yes or no?

A I think I've answered it, sir.

THE COURT: Well, I think the question is, is it a fair price or is everybody in the industry charging an unfair price?

BY MR. NORWOOD ROBINSON:

Q Can you answer that question, sir?

A Based on that, yes.

Q Based on what?

A What the judge just said.

THE COURT: So the answer is yes, that it is a fair [p. 3-180] price. Is that right?

THE WITNESS: Yes, sir.

THE COURT: All right, sir. Let's move on.

BY MR. NORWOOD ROBINSON:

Q Have you testified under oath, sir, that Liggett does not share any kind of monopoly power with any other tobacco company?

A Well, we certainly don't share any monopoly power, no.

Q And have you also testified that, to your knowledge, no two companies have ever conspired in any matter to form a monopoly as far as the tobacco company is concerned - industry is concerned?

A There's no monopoly. No, sir.

Q And have you testified, also, sir, that the cigarette industry is not a collusive oligopoly?

MR. HOGELAND: Objection.

THE COURT: Overruled.

THE WITNESS: What do you define as an oligopoly?

BY MR. NORWOOD ROBINSON

Q Whatever it was you meant when you testified under oath that there was no collusive oligopoly, sir.

MR. HOGELAND: Objection, Your Honor, the question was not defined when given to him before, and it was objected to as to the form. I renew my objection. These are not words Mr. Dey used in any testimony.

[p. 3-181] THE COURT: I renew my same ruling. Overruled. You may explain your answer if you need to.

THE WITNESS: Ask it again, please.

THE COURT: Did you testify --- Well, you were asking him if he testified to that is the question?

MR. NORWOOD ROBINSON: Yes.

BY MR. NORWOOD ROBINSON:

Q I want to know, sir, if you testified under oath that the cigarette industry is not a collusive oligopoly?

A That is correct.

Q Now, was it the truth?

A To the best of my knowledge, yes, sir.

Q And did you say, sir, under oath, that the price of branded cigarettes is a combination of elements including cost of goods, competitive environment and taxation?

A The price of cigarettes based on the cost of manufacturing, the cost of marketing, the taxation, they all go into the price, yes.

Q And so it's nothing but a fair price, right, sir?

A I don't really understand what you're driving at. I'm sorry, sir. What's a fair price or an unfair price? Based on the way you word it, yes, it's a fair price.

Q Sir, I want to show you a document that I have just three or four copies of.

MR. NORWOOD ROBINSON: I'm sorry I don't have

* * *

[p. 8-28] Q I want to know if you were aware of the fact - if you knew that your brokers were sending out information that Brown and Williamson's product could not be shipped because of this lawsuit, and that their product was of questionable quality?

A No, sir, I was not aware of that.

Q Sir, you sent almost monthly a written report, did you not, to Mr. J. W. Old, Junior, who was the president and chief executive officer of Grand Met U.S.A., Inc.?

A There were --- I sent two letters a year, one on the plan, one on the long-range plan, and then for a period of time I sent him some monthly status reports on the activity in the marketplace. I believe that's the other report that I sent. Other than that, I didn't send him anything.

Q Do you remember, sir, on July the 25th, 1984, that you wrote a letter to Mr. Old which said that "The incentive dollar battle now being waged in the generic category will likely preclude any further competition in the generic packaging area"?

A I don't remember that letter, sir. I don't remember that particular paragraph. I don't have it in front of me. That's five years ago.

Q I'll ask you, sir, if you remember writing a letter to Mr. Old that said that "The price segmentation, that is, the value added, and upscale packaging has resulted in an [p. 8-29] extremely volatile marketplace that should offer new brand positioning opportunities over the next few years"?

A Sounds like something that would be in that letter.

Q And do you remember telling him, sir, that the competition had substantially increased in the total cigarette market?

A That sounds like something I would write, yes, sir.

Q Well, was it true?

A Yes, sir. As I have defined "competition," competition has increased. Proliferation of items, the new price point positioning, the higher price for shelving costs, the shifting of advertising dollars as an industry from media to in-store promotional activity greatly increased the competitiveness from our standpoint as a manufacturer to get our products to the store on the shelves so they could be exposed to smokers and have the opportunity to buy our product.

Q Well, sir, is competition, as you define it, good for the American consumer? Is that the kind of competition you're talking about?

A Good, healthy competition in our capitalistic system ---

Q Could you answer my question "yes" or "no," and then you may explain it any way you want to. And it's simply this, sir. I'll repeat it to you. Do you say that competition, as you defined it - I think you've used that term several times.

* * *

[Excerpt Of The Trial Testimony Of H. Grant]

[p. 10-43] so that we acknowledged a significant unknown."

Q "Mr. Parrack, what was the rationale for the five volume breaks?"

A "To the point of minimizing diversion of B and W resources, particularly sales resources. We felt that if feasible, it would be greatly to our advantage to get our volume target from the fewest possible customers that would minimize the number of sales calls, the number of distribution points, the number of shipping instructions, and would make the launch of generics relatively more efficient, particularly from a time management standpoint."

Q "Did anyone at either of the meetings challenge that principle?"

A "It was questioned whether it was feasible. It was not questioned whether it was desirable."

Q "And did that discussion lead to a discussion of the allocation of available margins?"

A "Yes, it did."

Q "What was the rationale that you expressed for the allocation of available margin?"

A "Put the money where the volume is."

Q "Can you explain that for me?"

A "Yes. The margin structure outlined by the volume breaks allocates total discounts, with the greatest total discount going to the highest volume potential

accounts, those in the [p. 10-44] 25,000-case bracket, and then slide the discount rate down to Level 5, which is the smallest volume break account."

Q "And did anyone challenge that principle?"

A "No."

Q "What were the implications of the timetables that were discussed at these meetings?"

A "These were two principle implications. One was, if we wished to enter the generic segment by June of '84, we had to go through all the preliminary steps of readying the total offer in that time frame, so that approval to proceed was needed; otherwise, the start date would slide back during the year.

"The second discussion was specific feasibility and elements of each of those steps required to get home by June."

Q "Did anyone challenge the feasibility of the time allotted to each of those steps, at either meeting?"

A "Not that I recall."

Q "What conclusion was reached at either of the meetings?"

A "Both meetings responded favorably to the proposal to enter the generic segment, conditional to details being developed; in particular, further discussion of potential competitive response, especially Philip Morris and R. J. Reynolds."

Q "Can you tell me what the discussion at the two meetings

* * *

[p. 11-70] Brown and Williamson to GPC?

MR. MICHAEL ROBINSON: Objection.

THE COURT: Well, is the agreement in evidence?

MR. PECK: Not yet, Your Honor.

THE COURT: Sustained.

MR. FOSTER: All right. We'll offer it, and I'll go on to something else. And then we'll come back and offer it, Your Honor.

BY MR. FOSTER:

Q Prior to --- Going on to another subject for the time being, Mr. Grant, prior to the time that Liggett introduced generics in 1980, had there been any list price competition among the cigarette manufacturers?

A No, sir. There had not.

Q Were all king size - that is 85 millimeter cigarettes - sold at the same price?

A Yes, they were.

Q And how about all 100 millimeter cigarettes?

A And all the longs were sold at the same price too.

Q Prior to the time that Liggett introduced generics in 1980, what had been happening to the prices of branded cigarettes?

A They had been going up on a fairly consistent basis. And in the early '80s they started to go up twice a year.

Q How did price increases occur?

* * *

[p. 11-73] knowledge, he may testify.

BY MR. FOSTER:

Q All right. What's the basis of your knowledge as to how retailers sold -- the price at which retailers sold cigarettes?

A Well, you know, the list prices that the manufacturers put to the wholesaler were usually the list prices they were charged to the retailers.

Q Well, how do you know that?

A Well, you know, by going out. And, you know, we get reports in on what the retail prices are, what consumers are paying for products.

Q As a regular part of Liggett and Myers' business, do you monitor the retail price of cigarettes?

A Yes, we do.

Q Have you consistently monitored the retail price of cigarettes as long as you've been at Liggett and Myers?

A Yes, we have.

Q How long have you been at Liggett and Myers?

A Eighteen years.

Q All right, sir. Now I'll ask the question again. Do retailers, prior to your introduction of generic cigarettes in 1980, did retailers sell all 85 millimeter cigarettes at the same price?

A Yes.

* * *

[p. 11-109] Q How do you then, from a marketing point of view --- Has this decline in generic products, other than cigarettes, been reflected in a decline in the price value share of cigarettes?

A No, sir. It has not.

Q Why not, if you know from your marketing experience?

MR. NORWOOD ROBINSON: Objection.

THE COURT: All right. Are you talking about a decline in the price value share of cigarettes?

MR. FOSTER: Yes, sir.

THE COURT: It is not ---

MR. FOSTER: It's not declining. Price value cigarettes have grown in contrast to other generic products. And I'm asking him if, in his marketing experience ---

THE COURT: All right. He is a marketing man of cigarettes. He can testify as to why he thinks the category has grown. Overruled.

BY MR. FOSTER:

Q Okay. Go ahead, sir.

A Yes, sir. I can. You know, basically in the cigarette business through the states continually raising the tax on cigarettes, plus the industry taking two price increases a year, the absolute level of cigarettes have continued to rise very dramatically, and ---

Q Is that different from the market in other generic [p. 11-110] products?

MR. NORWOOD ROBINSON: Objection.

THE COURT: Well, to the extent of your knowledge as to whether the other generics take two price raises a year and have an increased tax, you may testify.

A No, sir. The other industries, I know, do not have state taxes on them, the majority of them.

Q Do they have two price increases a year?

A No, sir.

THE COURT: Did you say that the price of manufacturing cigarettes has not gone up since 1984; is that right?

MR. FOSTER: The cost, yes, sir.

THE COURT: The cost of manufacturing hasn't gone up since '84?

THE WITNESS: Yes, sir.

THE COURT: No salary raises for the workers since '84?

MR. FOSTER: While we're on that subject, why don't you explain to the Court and jury what is the basis for your statement that the cost of manufacturing cigarettes has not gone up since 1984.

THE WITNESS: Yes, sir. The cost of tobacco primarily has not gone up. There have been some minor, you know, increases on paper and filter, but they've been offset [p. 11-111] by, you know, the improvement of the

productivity through manufacturing, you know, faster equipment, et cetera.

THE COURT: I just thought maybe federal judges were working in the plant. So I wanted to find out, Mr. Foster.

MR. FOSTER: You need a union, Your Honor.

THE COURT: When he talked about no increases, I just wanted to check it out. That's all right. Go ahead. All right, sir.

BY MR. FOSTER:

Q I believe we've located some documents I wanted to ask Mr. Grant about earlier.

I'm going to show you Defendant's Exhibits 846 and 898 which Mr. Robinson showed to Mr. Dey during Mr. Dey's cross examination. Do these documents relate to relationships between Liggett and Myers and a chain called Super Value?

A Yes, sir. They do.

Q Who or what is Super Value?

A Super Value is a large grocery wholesaler.

Q Where are they located?

A Their corporate headquarters are located in Minneapolis.

Q Where, sir?

A Minneapolis, Minnesota.

Q All right, sir. Now who is Mr. Ray Rozar?

A He's an account manager for Liggett and Myers.

* * *

[Excerpt Of The Trial Testimony Of C. Eads]

* * *

[p. 22-166] and be sworn, please.

CLARENCE EADS, PLAINTIFF'S WITNESS, SWORN

MR. RASMUSSEN: Good afternoon, Your Honor. Good afternoon, ladies and gentlemen of the jury. I'm Garret Rasmussen, and I will be questioning Mr. Eads from the podium, simply because I'm more comfortable using a podium.

DIRECT EXAMINATION

BY MR. RASMUSSEN:

Q Please state your name.

A Clarence Eads.

Q Do you go by the nickname, Skip?

A Yes, sir, I do.

Q Where do you live?

A Metairie, Louisiana.

Q Are you married?

A Yes, sir, I am.

Q Is your wife here today, Mr. Eads?

A Yes, sir, she is.

Q Who do you work for?

A The Imperial Trading Company in Metairie.

Q What kind of company is that?

A The Imperial Trading Company is a wholesale candy and tobacco distributor.

Q I want to show you an exhibit.

MR. LONDON: Your Honor, may I request that the

* * *

[p. 22-170] products when you worked there?

A Between 80 and 85 percent.

Q And what were the annual sales of tobacco products by Eli Witt in the years that you were there?

A 1984 the total sales were roughly \$575,000,000.

Q Between 1978 and 1985, when you worked at Eli Witt, where was Eli Witt headquartered?

A In Tampa, Florida.

Q Is that where your office was?

A Yes, sir.

Q How many people did Eli Witt employ at that time?

A Between 1100 and 1200 employees.

Q And what was your job?

A My position was vice president of sales and operations of the company.

Q In that job, who did you report to?

A The president of the company.

Q Now you said that Eli Witt was headquartered in Tampa, Florida. Did it have locations outside of Florida?

A Yes, sir. We had 27 distribution houses throughout the southeast part of the United States.

Q Can you tell the judge and the jurors what responsibilities, if any, you had at Eli Witt in the period between 1978 and 1985, the period when Liggett came out with generics and then B&W came out with generics, what

* * *

[p. 22-185] A None that I can recall.

Q From the period between 1980 and 1984, what was the length of a typical new brand introduction rebate offer from a manufacturer to a distributor?

A On a new brand introduction, four to six weeks.

Q In your 18 years of experience as a distributor, what was the longest introductory rebate that you remember being paid from a manufacturer to a distributor?

A I don't recall any being more than six weeks.

Q Now, Mr. Eads, we've been talking about rebates. Let's go back to the franchise program that we were discussing earlier, which is the ten-cent or thirteen-cent program. Did you consider that to be a rebate?

A Not in the sense that we didn't have to earn it. We had to expend money to build the line, and those expenses came out of that 13 cents. And after the brand

was successful, a portion of that, yes, would have been profit for the company.

Q How do you, as a distributor, define "rebate"?

A Basically, a rebate is something that is offered merely for buying product and inventorying it, and having it available for sale, not necessarily having any work requirement or performance requirement to it.

Q Did you have to work for the ten cents or thirteen cents you got from Liggett under the franchise program?

A Yes, sir.

* * *

[p. 23-26] THE COURT: Sustained to what they could have achieved.

BY MR. RASMUSSEN:

Q Let me come about it a different way, Mr. Eads. How many branches does Eli Witt have?

A They had 27 branches at that time.

Q Was any one of those branches alone doing 1,500 cases per quarter of generic business with Liggett?

A No, sir, they were not.

Q Were any of those branches bigger than your competitors, standing alone? In other words, was one of your branches bigger than any of your competitors?

A Our branch operations were equal to, if not greater than most distributors in each of the areas that we serviced.

Q You say none of your branches were doing 1,500 cases per quarter?

A No, sir.

Q Prior to B and W's entry, had anyone -- had any cigarette manufacturer offered a rebate conditioned on purchasing 1,500 cases per quarter of cigarettes in one calendar quarter?

A I can't think of any. I'm not aware of any at this time.

Q In your opinion, Mr. Eads, did this volume requirement favor large distributors?

MR. LONDON: Objection.

THE COURT: Sustained.

[p. 23-27] BY MR. RASMUSSEN:

Q Could a distributor that did not have 1,500 cases per quarter of generic cigarettes have qualified for the 30-cent B and W rebate that was offered to you?

A It would be very, very difficult to do it.

Q Did Mr. Voorhees --- Was this meeting in Tampa?

A Yes.

Q At this meeting in Tampa, did he mention anything about whether the B and W rebates were to be passed on down the chain of distribution to the retailer and ultimately to the consumer?

A No, sir. In the presentation, it was continuously stressed that these rebates would be additional profits for

the company. And as a matter of fact, because they were going to have their sales force working the brand, we asked them how the rebates were not going to be passed on to the retailers, because their sales force would be making deals and offering allowances. And he said that the sales force would not know about the rebate or the amount of it.

Q Did he mention any consumer promotions to the consumer to be associated with this new brand introduction?

A No, sir, not that I know of, not that I remember.

Q In a usual new brand introduction at a wholesaler, is there discussion of consumer promotions?

A Yes, sir, the manufacturers on new brand introductions --- [p. 23-28] As I said earlier, the manufacturer has always been responsible for the promotion, the marketing, the merchandising of the product at the retail level.

Q Now other than achieving the 1,500 volume level with B and W, did Mr. Voorhees say there was anything else that Eli Witt would have to do in order to get that 30-cent per carton rebate?

A No, sir. The only thing that we had to do was to buy the product from them, have it available for distribution. There was no additional requirement whatsoever.

Q You say that you would use your 30 cents to buy carton racks like this (indicating)?

A No, sir. They would supply all of the racks and the point of sale advertising that would go on it.

MR. RASMUSSEN: Your Honor, this is Plaintiff's Exhibit 2377.

BY MR. RASMUSSEN:

Q Did Mr. Voorhees say anything about Liggett's ability to respond to B and W's rebate offer?

A Yes, sir. He was asked what he thought Liggett and Myers would do, would they respond to the 30-cent rebate. His reply was, "We doubt very much that Liggett can respond and match the offer and stay in business." That's the way it was left.

Q And what did you understand that to mean?

[p. 23-29] A That they didn't expect Liggett and Myers to respond to it, and that their offer would be sufficient to take over the black and white segment of the market.

Q Had any cigarette manufacturer ever said anything like that to you before at an introductory new brand meeting?

A No, sir. Not only cigarette manufacturers; no one that's ever met with me has ever said anything like that before.

Q Did Mr. Voorhees ever mention any marketing plans for his B and W Filter Light cigarette?

A No, sir. The only thing that he said they would do is their salesmen would work along with our salesmen to sell the brand.

Q How long was the B and W --- Start again. How long was the B and W rebate offer for?

A I believe it was one year, at the time they introduced it.

Q Did you, Mr. Eads, consider that one-year rebate offer to be an introductory offer?

A I don't know that we considered it as an introductory offer. I don't believe it was discussed in that manner.

Q How long are introductory offers in the cigarette industry with respect to offers from a manufacturer to a distributor?

A Introductory offers normally will last four to six weeks.

Q Let me put up Plaintiff's Exhibit 7025. The introductory

* * *

[p. 23-32] product at a generic price.

BY MR. RASMUSSEN:

Q As so called "branded generics"?

A Yes.

Q Now you told me and us that it took you and Liggett together about two and a half years to get this Filter Lights package going up to the 1,500 volume level?

A Yes, sir.

Q When did Mr. Voorhees want a response about his 30-cent offer to you for 1,500 cases a quarter of B and W Filter Lights?

A Well, they asked for a response that day. They wanted an answer at that time, but we told them that

there was something that we had to take into consideration, and that we would give them an answer within a week or so.

Q And then do you remember anything else about the meeting with Mr. Voorhees and Mr. Bolding in your office in Tampa in early June?

A I don't recall anything else right now.

Q Now after Mr. Voorhees and Mr. Bolding left, did you - what did you do next?

A Mr. Burnstein and I met in his office to discuss the Brown and Williamson proposal, and looked at our generic program as a whole.

Q As a manager of Eli Witt, did you have any [p. 23-33] responsibilities to the owners of Eli Witt?

A Certainly. It was part of my responsibility to maximize the earnings of the company.

Q Who were the owners of Eli Witt at that time?

A The owners were the Culbro Corporation in New York. They also owned other distributors.

Q Because of your obligations to your owner, did you at Eli Witt feel that you had an obligation to consider B and W's offer?

A Certainly we did.

Q Did you consider it?

A Yes, we did.

Q Did you compare B and W's 30-cent rebate offer to Liggett's program at that time?

A Yes, we did.

Q Which was more?

A The Brown and Williamson program, by far.

Q In comparing B and W's program with Liggett's program, did you take into consideration Liggett's response to Doral, the incremental program that we talked about earlier?

A No, sir, we didn't at that time. The Doral program was only in a test market, and really didn't affect our overall business.

Q When comparing Liggett's program with B and W's offer, did you take into consideration any retail programs that [p. 23-34] Liggett had at the time? In other words, programs where Liggett helped a retail store such as, for example, stickering?

A No, we really didn't. The retail marketing that was being done didn't have a really direct effect on the bottom line profits other than possibly an increase in sales.

Q Did you consider the retail programs that Liggett was offering to be a price cut to you as a distributor?

A No, sir. It had no effect on our price or the amount of earnings that we had. It was directed at the retail store and the consumer, and had no effect - again, other than possibly increasing sales, it had no effect on the earnings of our company.

Q When you and Mr. Burnstein were considering what to do, what aspects of B and W's presentation did you discuss?

MR. LONDON: Objection to what they discussed, Your Honor. It's hearsay.

THE COURT: All right. Well, he can tell us to what he considered himself in taking part in the decision.

BY MR. RASMUSSEN:

Q When you and Mr. Burnstein were considering what to do, what did you consider in deciding what to do?

A The amount of the rebate ---

MR. LONDON: Excuse me, Your Honor. May I just have a continuing objection to this line of questioning?

[p. 23-35] THE COURT: Certainly. But he's part of the decision-making process, and I think what he considered in the result is not hearsay, in my opinion, so I'm going to overrule the objection.

A The amount of the rebate was taken into consideration. The appearance of the package that -- the fact that we possibly could replace the Filter Lights that we already had in distribution was taken into consideration. The fact that their program -- we didn't have to buy any racks, any advertising materials, was taken into consideration. The entire program was evaluated against what we had as it reflected to the dollar amount that we would add to the bottom line of the company.

BY MR. RASMUSSEN:

Q Did you consider the similarity of the closure seals?

A We considered the similarity of the entire package, not any one particular thing.

Q But including the closure seal?

A Including, yes.

Q Now after your meeting with Mr. Burnstein, did you decide that someone from Eli Witt should call up the owners of your company?

A Yes, sir.

Q Did someone do that?

A Yes, Mr. Burnstein contacted Peter Strauss.

* * *

[p. 23-40] Q Now were there then a series of offers and counteroffers between Liggett and B and W?

A Yes, sir.

Q Do you remember the precise numbers of each of these rounds?

A No, sir. I know that it changed rapidly for five or six weeks.

Q At the time back then, do you know what the numbers were?

A Yes, sir. At the time I was very much aware of it.

Q Was there any pattern to this five-week series of offers and counteroffers? Was it leapfrogging one over the other, and then the other over the other?

MR. LONDON: Objection, Your Honor.

THE COURT: Was there any pattern?

BY MR. RASMUSSEN:

Q Was there any pattern to this rebate war?

A Yes, sir.

THE COURT: Overruled. You can testify.

BY MR. RASMUSSEN:

Q What was the pattern?

A Brown and Williamson would offer a rebate, and Liggett and Myers would respond.

Q Whose rebates were higher?

A Brown and Williamson's.

Q When Liggett responded, did it catch up to B and W?

[p. 23-41] A No, sir. The Liggett and Myers' rebates remained below Brown and Williamson's by seven to ten cents.

Q Do you remember what B and W's final offer was with respect to the shipments of its Filter Lights that would start in mid-July?

A Yes, sir. Seventy-five cents per carton, based on the level of product that we were currently purchasing from Liggett and Myers.

Q Do you remember what Liggett's final rebate offer to you at your volume level was?

A Yes, sir. Sixty-eight cents.

Q Just so I can be as fair as possible, is this 75 cents compared to 68 cents at the same volume level?

A Yes, sir.

Q Now when Liggett had its final 68-cent offer, did that include the 13-cent franchise allowance that we've been discussing earlier?

A Yes, sir. During this period of time from the first introduction by Brown and Williamson until the last offer was made, the requirements for us to buy the racks and the advertising was no longer our responsibility. Liggett and Myers would also supply those the same as Brown and Williamson.

Q So the final 63 cents from - excuse me - so the final 68 cent offer from Liggett was made up of the volume rebate

* * *

[p. 23-44] Doral at that introductory meeting that he had with you in June of 1984?

A I don't remember Doral being discussed at that time, no.

Q So before B and W came in, you were getting 13 cents from Liggett which you were spending on racks and on some types of advertisements, but not co-op advertisements; is that right?

A That's right.

Q And B and W came in, and they offered you what?

A Thirty cents per carton.

Q And Liggett responded and they offered you what?

A They responded with 20 cents per carton.

Q And then who went next?

A Brown and Williamson.

Q And then did Liggett respond?

A Yes, sir.

Q Did Liggett's response equal B and W's?

A No, sir. Liggett's response remained consistently seven to ten cents behind Brown and Williamson's.

Q So when Liggett responded and didn't meet B and W, what happened next in this rebate war?

A Brown and Williamson came back with another rebate offer.

Q And it widened the difference?

A Yes.

Q And what did Liggett do?

A They came back and made another offer.

[p. 23-45] Q Did that close the difference? Did it make it even again?

A It was not even. It brought it up closer again.

Q And then what did B and W do?

A They again came up with another offer.

Q And what did Liggett do?

A Liggett again responded.

Q Did they go up --- Tell me where to stop.

A Well, again, each time that this would happen, Liggett responded and would remain seven to ten cents behind the Brown and Williamson offer.

Q How do you know? How do you remember that?

A Well, at the time, this whole thing was so unusual, the - I guess the best way I can explain it myself is, if something happens to you in your life that alters your life or alters your lifestyle, you're going to remember it. And this was something so different that it was altering the way we were doing business. It offered us an opportunity to - as a distributor - to make a great deal of money that just normally did not happen in the distribution business. This is why I remembered it, the whole introduction.

Q How long did this series of things we've just been talking about go on for?

A Again, five or six weeks.

Q Was that starting in June 1984, continuing through

* * *

[p. 23-77] start again. You've talked about rebates and how Eli Witt didn't pass on those rebates to retail accounts. And in your answer you mentioned manufacturer's list price. What is the manufacturer's list price?

A The list price from manufacturers is the price that we pay for product before any discounts are taken off for cash terms. That type of thing.

Q Now how did you at Eli Witt decide at what price to sell your cigarettes to retail stores?

A The price that we charged the retail store was based on the manufacturer's list price.

Q That was before discounts such as rebates?

A Before rebates, before terms, discounts. It was strictly the list price that determined it.

Q And while you were with Eli Witt, was the manufacturer's price to you - say the Philip Morris price to you for Marlboro or for all the brand name cigarettes the same amount?

A They were the same from all manufacturers. It didn't make any difference which one they came from. They were all the same.

Q So are you saying that a manufacturer would not have a separate price for Marlboro and a separate price of another brand?

MR. LONDON: Objection. It's leading. Asking for [p. 23-78] a conclusion.

THE COURT: It is leading. Sustained.

BY MR. RASMUSSEN:

Q Was the manufacturer's list price for all one hundred millimeter branded cigarettes the same when you were at Eli Witt?

A Yes, sir.

Q Except for generics, since 1980, what has happened to the manufacturer's list price of branded cigarettes?

MR LONDON: May we have a time here now, Your Honor, since this gentleman has been in the industry and out of the industry. So I'd just like the time period in question.

BY MR. RASMUSSEN:

Q Well, while you were at Eli Witt between 1980 and time you left Eli Witt in 1985, what was happening to the manufacturer's list price of branded cigarettes?

A They continued to go up every year.

Q Now when you say --- When you priced --- When you were at Eli Witt, and you sold cigarettes to retail stores, you said you charged a price based on the manufacturer's list price?

A Yes.

Q How did you do that?

A Well, we had the manufacturer's list price, and then we

* * *

[p. 23-80] manufacturers ever compete at the wholesale level in terms of trying to replace one brand of cigarettes with another?

A No, sir.

Q Now you mentioned that manufacturer's list price of cigarettes has gone up, or at least went up when you were at Eli Witt. Is that right?

A Yes, sir.

Q And is it still going up while you've been at Imperial?

A Yes, sir.

Q While you --- In recent years, while you've been at Imperial, how often have the manufacturer's list price for branded cigarettes gone up?

A It's been every six months, or approximately every six months, since I've come back into the industry.

Q Now at the present time at Imperial --- Well, let's also go back to 1984. How often were manufacturers raising the list price of branded cigarettes in 1984 when you were at Eli Witt?

A They were still basically every six months, twice a year.

Q Now in 1984 when you were at Eli Witt, did you anticipate the date when cigarette manufacturers would increase their list prices for branded cigarettes?

A Yes, sir. We attempted to anticipate when their price would go up.

[p. 23-81] Q How did you know what date their price would go up?

A Well, we didn't know the exact date that they would go up, but we knew that they would normally go up about every six months.

So we would try to anticipate when we felt they would go up so we could start buying cigarettes ahead of time.

Q Why did you want to buy cigarettes ahead of time?

A Well, we would build an inventory in our warehouses. And when the price went up, we raised our price and sold the inventory that we had purchased at the old price at a higher price making larger profit.

Q And is that happening at Imperial Tobacco today?

A Oh, certainly.

Q Was there ever an occasion when you were at Eli Witt where you bought ahead, anticipating a price increase, and the price increase didn't take place?

A No, sir. The only mistake I made was not starting buying soon enough a couple of times.

Q Why was that a mistake?

A Well, if I had started buying sooner, I would have had that much more inventory and would have made that much more money for the company.

Q Now how did you actually find out when a manufacturer increased the price of a branded cigarette when you were at Eli Witt?

[p. 23-82] A We would receive a Mailgram from the manufacturer, notifying us that the price increase and the new list price on their brands.

Q And say you got --- Did you ever get a Mailgram from R.J. Reynolds?

A Certainly.

Q And let's assume R.J. Reynolds was first. When you got a mailgram from R.J. Reynolds raising the manufacturer's list price for the Reynolds cigarettes, what did you do?

A We immediately raised our price on all cigarette brands that we had in the warehouse.

Q Just the Reynolds' brands?

A No, sir. Every brand. All manufacturers' brands.

Q You mean you raised the price of other manufacturers' brands even before they sent you a Mailgram?

A Certainly.

Q Why?

A Well, we knew that within hours, if not a few days, we were going to receive a Mailgram from the other manufacturers. They always followed suit. They've always been the same price. Never any price differential.

Q Let's turn back to the time period when you were a retailer. Did you have responsibility for setting the retail price of cigarettes?

A Yes, sir.

* * *

[p. 23-94] THE COURT: Yes, sir, up until that question [sic]. The two previous ones were repetitive. But let's see if we can finish up on this direct here before lunch.

MR. RASMUSSEN: We should be able to, Your Honor.

BY MR. RASMUSSEN:

Q Is Philip Morris now making black and white generics?

A Yes, sir. They are.

Q Is Philip Morris -- is the Philip Morris black and white generic package similar to your -- to the Filter Lights' package that you had when you were at Eli Witt?

MR. LONDON: Objection.

THE COURT: Overruled.

A I've not seen any that are -- that resemble it, no.

BY MR. RASMUSSEN:

Q What does Philip Morris have on its closure seals?

A They have an eagle on their closure seal, on all of their black and white packages.

Q Was Philip Morris making as big an effort at persuading you at Imperial to market black and white generics as Liggett made when you were at Eli Witt with respect to the Liggett Filter Lights?

MR. LONDON: Objection.

THE COURT: Overruled.

A No, sir. Philip Morris has contacted me at Eli Witt, but they have presented programs on a contract basis for [p. 23-95] private label. They appear to be more interested in private label ---

THE COURT: Well, sustained to your speculation about what Philip Morris's intent is.

BY MR. RASMUSSEN:

Q With respect to what you observed to the black and white generics, how does Philip Morris's effort now with its black and white, not its private label, compare with Liggett's effort that it made when you were at Eli Witt with those Filter Lights?

A They made no presentation to me on just buying black and white. It's only been on a contract basis for a private label.

Q Does Reynolds now have a black and white generic?

A Yes, sir. I understand they do. I have not seen it.

Q Was Reynolds making as big an effort to persuade you at Imperial to buy their black and white as Liggett made with respect to its Filter Lights?

A I've never seen it. It's never been introduced to me.

Q Are you aware of what has happened to the price of cigarettes since B & W has come into the generic market?

A I'm sorry. I didn't understand your question.

Q Are you aware of what has happened to the price of cigarettes, in terms of whether they've gone up or down, since B & W's generics came into the market?

* * *

[Excerpt Of The Trial Testimony Of T. Sandefur]

[p. 26-5] (Jury in at 9:40 A.M.)

THE COURT: Good morning, ladies and gentlemen. You will remember yesterday that Mr. Eads was on the stand, and we're going to finish with Mr. Eads this morning, I am confident.

So, Mr. Eads, if you'll come back to the stand.

And, Mr. London, I believe you have a few more questions for Mr. Eads?

MR. LONDON: Yes, sir. Thank you, sir.

CLARENCE EADS, PLAINTIFF'S WITNESS,
PREVIOUSLY SWORN
CROSS EXAMINATION (CONTINUING)

BY MR. LONDON:

Q Good morning, Mr. Eads.

A Good morning, Mr. London.

Q Mr. Eads, I want to just clear up a few little odds and ends. First, it is true that it was your observation that as of December 1985 there was more price competition in the cigarette industry than there was before June of '84?

A In December 1985?

Q Yes, sir.

A Yes, sir, from observations that I had at the time at the retail level stores that I frequented, yes.

Q Now, sir, one of two clean-up questions on that meeting in June. You testified that when you walked into the meeting with Bores and Bolding, you saw the packs on the table at

* * *

[p. 27-108] approval of Brown and Williamson's plan?

A No, sir. We would not be required to ask Mr. Bruell for approval. No, sir.

Q Well, I didn't ask you if you were required. I asked you did you ask Mr. Bruell for his approval?

A No. We had discussions with Mr. Bruell. We certainly would like for Mr. Bruell to support our position, but it wasn't required that Mr. Bruell approve what we, as Brown and Williamson, were doing.

Q Did you need anybody in London to approve whatever Brown and Williamson wanted to do, Mr. Sandefur?

A Absolutely.

Q Who?

A Well, initially we needed approval and agreement from Mr. Gerald Dennis.

Q Now who was Mr. Gerald Dennis?

A Mr. Gerald Dennis was, I believe, vice chairman of BAT Industries.

Q And BAT Industries is the public limited company of which BATCO is a subsidiary? Is that right?

A That's right. But Brown and Williamson would need BATUS which is U.S. approval. That's our first --- That's the reason I asked about what are we talking about. A direct line relationship here.

The way it worked is that we would need BATUS approval. . . .

* * *

[p. 27-177] price for a pack of cigarettes. If it's banded together on buy one, get one free, the consumer knows that that's a value. It's half the price.

Q You told the press, July 25, 1985, one key on the cash register rang up all cigarette sales, didn't you, Mr. Sandefur.

A I did, yes.

Q Yes, you did.

A That's correct. And I didn't tell the press - because I didn't think it was important, I didn't tell the press that there are buy-one-get-one free's out there that represent a price value to the consumer. I was making a general statement.

Q And you were talking about value for money cigarettes and price values for the consumer at this press conference, weren't you?

A That's correct.

Q And you didn't think all of the buy-one-get-one free's and all the tape-on's were important?

A Yes, I think they're very important.

Q Well, you just said you didn't, and that's why you didn't tell the press.

A I didn't think that it was important for me to go through the entire marketing situation in the United States with the press corps. No, I did not.

* * *

[p. 28-76] testify to.

THE COURT: All right.

A It deals with how this was being done. It was being done through the real list price of generics to major accounts - discounting from list, from price through various discounts ---

BY MR. HOGELAND:

Q Would you tell us what page you're reading from?

A On page 18. Through various discount schemes and promotional allowances. So what they have done was they had gone to the wholesale trade through their rebate program and done just this.

Q Done just this?

A Yes.

Q Widened the price differential between branded and generics. Is that right?

A What they had done is, they knew that some of these rebates were being passed on. Yes.

Q Well, they lowered the list price, didn't they?

A They lowered the list price. When we came in, we had the same list price as they did.

Q Yes, and all the time from this period - December '82, July '83, December '83 - when the rest of the industry, including Liggett, raised prices on branded cigarettes, Liggett and Myers chose not to raise prices on their

* * *

[p. 28-81] A Right. It also says "Military Separate."

Q It also says "Military Separate."

A And the reason military is separate is because the military doesn't allow rebates. So Liggett and Myers had a lower list price in military because they didn't allow the rebate scheme. The government doesn't allow that.

Q And they don't allow value discounts, do they?

A That's correct.

Q And in the military Brown and Williamson came in with price competition, didn't it?

A We matched what Liggett and Myers was doing. Yes.

Q You lowered the list price below what Liggett and Myers' was, didn't you?

A We came in at, I believe, sixteen seventy-five. I believe that was the figure.

Q But your plan before Doral came in was to lower the list price, wasn't it?

A I don't recall that.

Q You don't recall that?

A That's right.

Q Now my question was that the program included structuring terms and discounts based on volume and exclusivity. Is that right?

A Yes, that was what Liggett and Myers had done. Liggett and Myers had set the ground rules for competing in this [p. 28-82] category, and when Doral came in they recognized that. And when we followed Doral we recognized that. Doral had the volume rebates - five volume rebates as well.

Q Now it says here on number two "Five Levels of Rebates." Is that correct? Or discounts as they called them then?

A That's what that says. Yes.

Q Well, when B & W came into the generic business at the end of May 1984, it came in with five levels of rebates, did it not?

A That's right. We wanted to have some people that did less than the two hundred and fifty to participate in our program. Yes.

Q And that's the reason you had five levels so people below two fifty could participate, Mr. Sandefur?

A I'm sure that was part of our thinking at that time. We thought that if we had different levels, it would encourage the direct accounts to take on our brand and to encourage them to move to a higher bracket. That's why you have different prices in the bracket so that they can - as their volume increases, they can participate in the higher bracket.

Q My question was, when B & W entered the generic cigarette business ---

A We had five brackets.

Q You had five levels of volume rebates just as was

* * *

[p. 29-186] A I introduced the brand, yes, sir.

Q And at that time, it was very successful. Is that right?

A Yes. It was relatively successful. It declined, however.

Q And then here in 1984, Reynolds relaunched Doral at generic price. Was that a different cigarette, Mr. Sandefur?

A Yes, sir. It was a totally different cigarette.

Q And it was also priced at the same list price as Liggett and Myers' generics. Is that right, Mr. Sandefur?

A I believe that's correct. Yes, sir.

Q And then it says, "As anticipated in B&W's March document, RJR has launched a generic priced product line as a first priority response to generics." Now that says that Reynolds' repositioning of Doral was a response to Liggett and Myers' generics, doesn't it, Mr. Sandefur.

A That's what it says, yes, sir.

Q And then it says, "This action flows from RJR's stated policy to be represented in all major segments of the category. They further believe - contrary to our analysis and data - that the existing awareness and good will of an established brand will give Doral a point of difference in superiority versus black and white and private

label." Now, Mr. Sandefur, what was B&W's analysis and data that was contrary to that belief of Reynolds?

* * *

[p. 30-25] excess of what it cost you to make, right?

A We have a pro forma that we'll get to in a moment. Yes that's correct, yes.

Q So Brown and Williamson's variable margin increased from \$2.91 a thousand in 1972 ---

A Right.

Q --- to \$8.78 a thousand in 1981?

A Right.

Q An increase of over 200 percent?

A That's correct, yes, sir.

Q Then, "In 1982, the industry became much more aggressive on the pricing front." Now what does that mean, again, that - we talked about this yesterday - what does becoming "more aggressive on the pricing front" mean?

A The industry - and when I say "the industry," I'm talking about all manufacturers in the industry - were taking price increases more frequently, and the magnitude of the increase was greater.

Q So that here when you use the idea of aggressive pricing, you mean increasing prices ---

A In this case ---

Q --- more frequently and by greater amounts; is that right?

A In this case that's what we are referring to, yes, sir.

Q And then it says, "Fueled by a 100 percent increase in the federal excise tax."

[p. 30-26] A Yes.

Q In other words --- What does "fueled by" mean?

A If you throw gasoline on a fire, that's fueling it. That makes it - it fuels it, yes.

Q The 100 percent increase in the federal excise tax fueled the industry's becoming more aggressive on the pricing front; is that what that means?

A Yes.

Q And Brown and Williamson's variable margin then increased from \$10.78 in 1982 ---

A Right.

Q --- to \$12.61 per thousand in 1983 as a result of this aggressive pricing; is that right?

A That's right. As if Philip Morris, or R. J. Reynolds leads a price increase, as we've discussed before, and the wholesale trade takes everyone's price up immediately, that means that you raise the price and it fuels the increase, certainly.

Q And this compares 1982 variable margin with 1983 variable margin; is that right?

A That's correct, yes, sir.

Q But then this prior sentence, your variable margin in 1981 was \$8.78 a thousand, right?

A That's correct.

Q And that already by 1982, just one year later, it's up to [p. 30-27] \$10.78?

A That's correct, and I ---

Q So it went up \$2.00 from '81 to '82; is that right?

MR. NORWOOD ROBINSON: Let him finish.

A That would --- Yes, that would be what this calculation would indicate. I would also add that I can't tell you what our competitors' margins did. They may have gone up a little less than that, and then in some cases I would suspect they went up more than that.

BY MR. HOGELAND:

Q Brown and Williamson's went up?

A In the case of Brown and Williamson, that's what our margins have done during this period, yes.

Q Including a \$2.00 increase from 1981 to '82, and an almost \$2.00 increase from '82 to '83, right?

A Yes, sir, that's correct.

Q Now those variable margin increases were all based on full revenue products; is that right?

A Regular-priced products, yes.

Q Those are full revenue branded cigarettes, as we call them here?

A Winston, Marlboro, Kool, L & M.

Q Brown and Williamson's margins are based not only on Winston and Marlboro?

A No, that's correct. Pardon me. I misunderstood your

* * *

[p. 30-75] the two thirty-five which would have been five point one million dollars.

[A] I would further point out that while this is the Brown and Williamson recommendation, the financial aspects of the Brown and Williamson recommendation were not accepted by BAT or BATUS. We were, in fact, required to make a profit. So the idea that while we've got zeros across there, this was not accepted by our parent company.

Q But you say on this two thirty-five line that that is a reserve for either trading profit or additional trade allowances. Is that right?

A Yes, and we believe ---

Q And that reduces to zero the bottom line.

A And that's purely a pro forma calculation showing in our recommendation -- showing what would happen. We said we would be prepared to take it down to break-even, not below break-even but to break-even. That was why it shows that that way. We have a reserve for trading profit which can be used for trading profit or additional trade allowances.

We didn't know at the time how much we would have to spend. We had hoped that we wouldn't have to spend more than a dollar sixty-five in terms of trade allowances in order to get into the business. But we certainly intended to make money.

And as you see, in 1985 we had forty-three million

* * *

[p. 30-80] found when we entered the market would remain the same. [A] The spread that Liggett and Myers had, through a price increase in March, had gone to. That's what we were saying would be maintained.

Q And you wanted to manage the category growth by preventing an increase, didn't you?

A Well, Mr. Hogeland, the only time Brown and Williamson ever tried to lead a price increase in the value-for-money segment, we didn't make it stick and had to roll it back.

Q Mr. Sandefur, you wanted to talk about a footnote on the chart in the May 15 document.

A Right.

Q Where you wanted to say that you were going to maintain the price spread at thirty-five percent. Is that right?

A I said that was the assumption. I didn't say that we were maintaining the thirty-five percent price spread. I said, for the purposes of the document that we look forward to BAT, this was the assumption that we made regarding pricing.

Q That it would be maintained the same?

A For the purpose ---

Q I'm sorry.

A For the purposes of this proposal. That was the financial assumption that we had given our finance

department to calculate the pro forma P & L on our recommended entry. . . .

* * *

[p. 30-121] Q And we had here, Mr. Sandefur, a line called "Full Variable Margin Rate per Thousand." Is that right?

A It says "Variable Margin Rate per Thousand." Yes.

Q Variable Margin Rate Per Thousand 1984 was \$4.65. Is that right?

A That's correct, yes.

Q So if indeed Brown and Williamson responded to probable L & M counter offers by increasing volume discounts up to full variable margin, then this trade allowance line, which is a rate per thousand of \$1.65, would change, wouldn't it?

A That's correct, yes.

Q And that would change to \$4.65, wouldn't it?

A That's correct, Mr. Hogeland. At the bottom of the chart where we are talking about Reserve Available Trading Profit ---

Q Down here?

A Yes. That would mean that you take out everything else. That would bring us down to zero. But I would point out that while this was a recommendation that Brown and Williamson made, BAT did not approve, this and on May 22, 1984, we were advised by BATUS of

what B-A-T would allow us to do and what we were told, that this was ---

MR. NORWOOD ROBINSON: Your Honor, I move to strike this answer. The witness is not responsive, and it's going in to hearsay.

* * *

[p. 31-52] its share of this segment."

A Right.

Q Now that is the same objective that Brown and Williamson documents talked about a year earlier, is it not? Reducing the spread between generics and full-priced production?

A As I indicated, as the spread widened and the financial data that we had in our assumptions assumed some thirty-five percent spread, that we believed that we would have an opportunity to take a price increase. And at this particular point in time, if memory serves me correct, the price was -- prior to the June increase -- the spread was some forty percent.

After the June price increase -- because of the regular-priced products taking a price increase -- it moved up to forty -- some forty-two percent. So we thought there was an opportunity for us to take a price increase. We weren't living up to the commitments that we had been given by BATUS in terms of our profit objectives, and we thought there was an opportunity for that. Yes.

Q And what you said was that you would hope to reduce the spread. Is that not right?

A Yes.

Q And then you say, "B & W's presence within the segment appears to have resulted in reduced consumer advertising by Liggett and Myers and a slowing in the segment's growth [p. 31-53] rate." Is that right?

A As I've testified earlier, yes.

Q And isn't that what B & W set out to accomplish, slowing the segment's growth rate, Mr. Sandefur?

A I believe we've discussed that many, many times over the past few days.

Brown and Williamson or no other tobacco company in the industry can tell the consumer what to do. We've talked about what products we would introduce, but the fact of the matter is that the consumer makes those decisions.

The decision that Liggett and Myers made was their decision with regard to changing the advertising.

Q And this is Mr. McCarty's speech that you're suggesting he make, is it not?

A That's what we were suggesting. Yes.

Q And you're suggesting that he say in the speech exactly what your 1984 documents say, that B & W's presence within the segment resulted in a slowing of the segment's growth rate. Is that right?

MR. NORWOOD ROBINSON: Objection.

THE COURT: Overruled.

A The recommendation speaks for itself, Mr. Hogleland. That was our view at the time. We knew that Doral

was growing very, very rapidly, but that was our - that's what we said. Yes.

[p. 31-54] BY MR. HOGELAND:

Q Well, in March of 1985 - excuse me - April of 1985. You say Doral was growing very, very rapidly?

A In March of --- No.

Q April of '85.

A No, because - Excuse me. Yes. Doral was growing in April of 1985.

Q Was it growing very, very rapidly?

A Well, it was showing growth.

Q But it wasn't growing as fast as B & W's generics 1985, was it, Mr. Sandefur.

A I believe it was, Mr. Hogeland, if memory serves me correct. I may be remembering incorrectly. I remember in 1984 Brown and Williamson shipped some two point two billion sticks, and I believe R.J. Reynolds shipped two point one billion sticks in 1984.

And certainly Doral today is the number one brand value-for-money segment, and it was growing - yes - during this period of time.

Q Well, you testified that at this time - April of '85, Doral was growing very, very rapidly, didn't you, just a minute ago?

A That's what I said. Yes.

Q And was B & W generics growing very, very rapidly, Mr. Sandefur?

[p. 31-55] A No. I wouldn't characterize B & W's generics as growing very, very rapidly. We were showing progress in 1985, particularly at the end of the year in 1985 when we held our price. At mid-year we were able to show some progress in terms of getting distribution at the wholesale level. We did not meet our volume objective in 1985. We fell short of it.

Q But in 1985 B & W generics were growing just as fast as Doral, weren't they?

A I don't recall the relationship.

Q Well, you just testified that in 1985 Doral was doing - growing very, very rapidly.

A Doral was growing. Yes.

Q The same rate as B & W. Right?

A I don't recall if it was the same rate.

Q Now calling your attention, Mr. Sandefur, to what is tab 22 in your binder ---

A Yes, sir.

Q --- Plaintiff's Exhibit 960. Here again we have a memorandum from you to all of B & W's vice presidents. Is that right?

A Yes.

Q And this again is dated April of 1985. Is that right?

A That's correct.

Q And this again is a limited distribution document. Is that right?

. . .

[p. 31-162] that could grow and grow very well, and it has. Yes.

Q And then Mr. Frigon goes on, "As we had anticipated, the rate of growth of this segment has slowed since B&W entered the market with generic products." Now that was a true statement as of July 18, 1985, isn't it, Mr. Sandefur?

A Yes. What had happened was consumers were going over to branded generic price products, yes, sir.

Q And it says, "As we had anticipated." Isn't that right?

A That's what it says, yes.

Q And that is exactly what B&W entered generics in order to achieve, isn't it, Mr. Sandefur?

A I don't understand the question.

Q Beg your pardon?

A I don't understand the question.

Q Wasn't that B&W's purpose in entering generics?

MR. NORWOOD ROBINSON: Objection, sir.

THE COURT: Overruled.

A What was it? I don't understand the question.

THE COURT: Ask the question again.

BY MR. HOGELAND:

Q Wasn't B&W's purpose in entering generic cigarettes to slow the rate of growth of that segment?

A No, sir. I told you, Mr. Hogeland, that the manufacturer cannot slow the rate of growth of any category in this business. The consumer makes that decision.

* * *

[p. 33-103] the chairman of BATUS.

Q Are you telling us, sir, that your superiors told you that you could not go into this market if it was possible for you to have to go down to break-even, sir?

MR. FOSTER: Objection. Leading.

THE COURT: Sustained as to form.

BY MR. NORWOOD ROBINSON:

Q What, if anything, was your understanding, sir as to what BATUS responded to you when you brought that proposition to them that showed a two dollar and sixty-five cent profit with the possibility of having to use all of the profit, if necessary, to meet competition?

A That was unacceptable, and the recommendation on the financial side was rejected out of hand.

Q Sir, would you state whether or not that means that those previous statements, as well as the statement in the May proposal, were no longer operative?

A Yes, sir. Dr. Hughes and I certainly knew that.

Q Did the document, sir, discuss tax savings?

A Absolutely. That plays a very key role in our business. And when you asked me the question earlier and you asked me about the five million, that was part of it. We had another five million dollars that we expected

in terms of our tax savings by entering this business. So that brought us to a ten million dollar level, a little bit more than ten million [p. 33-104] dollars.

Q And that is what you expected or hoped to make on it the first year. Is that right?

A Yes, sir. Yes, sir.

THE COURT: Tell us again where you got the first five million.

THE WITNESS: The first five million.

THE COURT: You were talking about Charlie's dollar or something of that nature.

THE WITNESS: Yes, sir. We're talking two different subjects, Your Honor. What we had said was we were recommending that we take it down to break-even. They told us no. Said, "You've got to make a minimum of a dollar a thousand." That deals with the five point two million.

THE COURT: All right. So there --- If you made a dollar a thousand, the projection would be five point two million.

THE WITNESS: No, sir. No, sir. It wouldn't be. The five point two is what we --- See, Charlie said, "I understand you've got two dollars and thirty-five cents potential in here, but I'm rejecting this, taking it down to zero, the zero line." Said, "You've got to make a minimum of a dollar a thousand."

THE COURT: He said you could go down to one dollar?

[p. 33-105] THE WITNESS: Yes. On this sheet over here.

THE COURT: Right.

THE WITNESS: All right, sir. But on this other sheet, you see where we've got - where it talks about Plan LIFO Decrement. You see that eleven point two million dollars?

THE COURT: Yes, sir.

THE WITNESS: Cut that in half. That's a little over five million dollars. That's what we expected the tax benefit to be to our company. So in total we were looking at the potential - if everything worked as we had planned - spending a dollar sixty-five in trade allowances and everything that went into that, we would expect to make a little over ten million dollars.

THE COURT: All right. Based on the dollar a thousand plus the tax benefit. Is that right? That's where I'm losing it.

THE WITNESS: Okay. Let me see if I can explain it this way.

MR. FOSTER: Your Honor, before Your Honor gets into that, I know Your Honor has not ruled on that Motion in Limine. If Your Honor is going to allow testimony with regard to LIFO Decrement in - into evidence, could we just have a continuing objection to all of that?

THE COURT: Yes, sir. You can. I understand that. [p. 33-106] But, yes, sir. And I am going to let it into evidence.

One more time. Maybe I'm a little --- Everybody in the courtroom may understand it.

THE WITNESS: I apologize, Your Honor. The five point two million dollars would generate two dollars and thirty-five cents. That would have been the profit, you see, on this Bates Number 087072.

THE COURT: Okay. I'm on the wrong page. Okay. I can find it.

THE WITNESS: Based on selling two point two billion cigarettes in 1984 ---

THE COURT: All right.

THE WITNESS: --- and making a profit of two dollars and thirty-five cents, that would generate five point one million, five point one seven zero million dollars.

And Charlie said, "No."

Then we had a zero underneath that, and we had reserve for trading profit or additional trade allowances, that two thirty-five. And Charlie said, "No. I'm not going to let you do that. You've got to make money from the start on this business. I'm not going to let you do that. You've got to make a minimum of a dollar a thousand."

THE COURT: I understand. But that makes your reserve or trading profit then a dollar thirty-five. Right? Instead of two thirty-five?

[p. 33-107] THE WITNESS: No sir. What makes it --- It makes it a dollar thirty-five that we could put -- potentially put up in the -- with the dollar sixty-five, you see, leaving a dollar a thousand profit.

THE COURT: Right. Right. I understand.

THE WITNESS: That was what he said to us.

BY MR. NORWOOD ROBINSON:

Q Is it correct, sir, that what management told you was that that figure -- as His Honor asked -- two thirty-five could only be one thirty-five so that that figure zero would be a dollar?

A That's correct. Yes, sir.

Q In other words, you could only use a dollar and thirty-five cents ---

A That's right.

Q --- of what you thought the profit was going to be to meet competition.

A Yes, sir. That's correct. That's what Charlie asked us to do. But we also knew that we had a substantial tax savings by entering this business. It played a key role in Wally and Tommy Sandefur taking this thing forward. A very key role.

Q Sir, do you have any documents to confirm this one dollar commitment you made to BATUS?

A Absolutely.

* * *

[p. 33-187] activities is neither here nor there. Of course, you can support him by showing that it -- perhaps if necessary, that it wasn't true, but that's another question for another day.

MR. HOGELAND: But this question should be "What did you rely on in making that decision?" rather than, "What, if anything, have you heard?"

THE COURT: I don't see much difference, but let's go back and try it again.

(End of bench conference.)

THE COURT: All right. The question is what he heard and relied on, Mr. Robinson, I believe. Let's restate the question.

BY MR. NORWOOD ROBINSON:

Q What did you hear and rely on in making your pricing decisions on, sir?

A My pricing decisions in August were that I needed to start some stickering because I needed to demonstrate to the wholesale trade and to the retail trade that I believed in my product, and I was going to do something to demonstrate further that I was in it for the long term and stickering was a way that I chose to do that. Because it's very important when you make a call on a wholesaler to be able to tell them that you're going to be doing stickering because it moves product out of his warehouse. It also moves product out of the retailer's warehouse. So that was another pricing [p. 33-188] decision that I had to make in August of 1984. And what I was doing it on - based on was what I believed to be the case that Liggett and Myers was disparaging my product, continuing to use the lawsuit, continuing to try to keep me out of the market, both at wholesale and now at retail.

Q And the lawsuit continued through December 31, 1985, did it not?

A The lawsuit is continuing today.

Q Yes, sir, I know, but just tell me - can I get you past December 31st '85. That's what the magic date is right now. It was in effect then, wasn't it, sir?

A Yes, sir.

Q Okay, sir, and did you continue to take that into consideration when you made pricing decisions?

A Absolutely. From the first day on, after they started doing what they were doing, that was part of the decision process that my mind went through in making my decision. Yes, sir.

Q Can you tell us, sir, whether or not you received reports that customers were cancelling orders that they had placed for your products?

A Yes, sir. They were. They ---

Q And what, if any, reports did you receive as to what the customer was saying - why they were cancelling the orders, sir?

* * *

[p. 34-90] 098506 of Plaintiff's Exhibit Number 15.

A Yes, sir. I have it.

Q This document is dated May 17, 1984, isn't it, Mr. Sandefur?

A Yes, sir. That's correct.

Q And this is after you had made your recommendations. Is that correct?

A That's right, but before BATUS told us what they wanted.

Q But it was after you all had signed off on that recommendation document we just looked at. Right?

A It's not approved until BATUS approves it, Mr. Hogeland.

Q But Brown and Williamson, including you and Dr. Hughes, signed off on that recommendation. Right?

A We had made a recommendation. Yes.

Q You agreed with it. Right?

MR. NORWOOD ROBINSON: Objection.

A We made a recommendation. Yes, sir.

THE COURT: Go ahead.

BY MR. HOGELAND:

Q And under the strategies here that Mr. Christensen wrote down later and sent to Mr. Butler and Mr. Blott ---

A Right.

Q --- it says, does it not, that you're going to construct an initial offer superior to L & M's but at minimal B & W cost and offer it to selected key customers? Isn't that

* * *

[p. 34-153] A Yes, sir. I guess. I haven't done the math. Yes, sir.

Q Well, I have trouble with it, too, when it's that big.

A Yeah.

Q But I believe \$1.00 times two billion two hundred thousand dollars is two million ---

A Sounds right.

Q --- two hundred thousand dollars - I mean, two billion two hundred million is two billion two hundred thousand.

A Yes.

Q And then Mr. Bacon reported to you in round numbers that actually in 1984 you had a four-hundred-thousand-dollar loss as trading profit, didn't you - didn't he? He told me the number 378, which I round to four, is that right?

A All right. Fine. Fine.

Q If we use the round numbers. And that's a total of two million six hundred thousand dollars less than the dollar trading profit in 1984. Is that right?

A Right. But we all knew - Mr. McCarty and all of us knew what we had with regard to being in this business. The bottom line to the company, the tax benefit, implications of being in this business. It was very, very important to us. It was significant to us. Mr. Bruell said in his telex back to us, Mr. Hogeland, and as you know, that even though he had difficulty supporting what our people were recommending, that the benefit of the - the tax benefit may, in fact, change his [p. 34-154] mind. It was

very, very important to us. It was key in what we were doing. We knew that bottom line, we were going to make money.

Q Can you explain that to me, Mr. Sandefur? If you can't explain trading profit, can you explain LIFO decrement avoidance?

A I cannot. I can tell you that it represents a tax savings and it is my understanding if your volume is going up, you get a benefit. And Mr. Bacon can take you through that chapter and verse. He knows it. Ray Pritchard, Wally Hughes before him, and I don't pretend to understand the LIFO decrement, but our finance people understand it inside out, and I hope you are prepared to talk to them about it.

Q Now, Mr. Sandefur, trading profit is what we're talking about when we are talking about Charlie's dollar, right?

A Yes, sir.

Q Now didn't Mr. Bacon report that in 1985, Brown and Williamson's generic cigarettes had a trading profit loss?

A Of seven hundred - about seven hundred and fifty thousand dollars; yes, sir.

Q Wellm [sic] I'm talking about 1985.

A Yes, sir.

Q Didn't he report in 1985, B & W generic trading profit loss of one million six hundred thousand dollars?

A I don't recall that number. I recall 750; and if we're . . .

* * *

[Excerpt Of Trial Testimony Of T. Olges]

[p. 35-204] category, raising prices makes profitable so we'll get more competition.' Do you recall having said that?"

"Not specifically."

"Generally, do you recall?"

Answer: "Recollection was it was more of a group consensus that they agreed. Who stated it, I don't remember. But that was the feeling of the group there."

Did you give that answer to that question under oath at your deposition?

A Yes, sir.

Q And the group that you referred to was Mr. Pritchard, Mr. Alar, Mr. Sandefur, and eight other vice presidents or senior vice presidents of Brown and Williamson, isn't that correct?

A Yes, sir. Those at the meeting.

Q Let me ask you one other question. At this meeting, did Mr. Sandefur ask, "Why can't Brown and Williamson go up 75 cents a thousand cigarettes on January 1986 and again on July 1986, which will narrow the gap in generics?" didn't Mr. Sandefur say that at this meeting?

A There ---

Q That's what your notes show, don't they?

A On Page 3 of the notes.

MR. NORWOOD ROBINSON: Objection.

THE COURT: Overruled.

Q And that's what your notes of that meeting show?

[p. 35-205] A On Page 3 of the notes, that's what appears to be there. That's the words there on the page; I don't remember what was said specifically any more than the notes show.

Q But you remember that you wrote down those notes and you put "T.E.S." above that statement, didn't you?

A Yes, sir.

Q "Will narrow the gap in generics." So there was discussion, wasn't there, of narrowing the gap in generics at this meeting?

A There's that comment, yes, sir, out of those notes.

Q And the check mark, Ms. Olges - the check mark means what?

A I don't recall that. I had done something with it, but I don't recall what exactly was the next step after the notes.

Q The check mark means that that is part of the plan, doesn't it?

A I'd have to pull the pricing out they used in the five-year plan, whether it was the exact pricing used.

Q The check mark means that that was going forward into the plan, doesn't it, to narrow the gap on generics?

A The pricing out of this meeting would go into a draft. This is in July, sir.

Q Okay. And in July of 1985, they were going to narrow the gap; that's the plan, right?

A It says, "75 cents first of '86 and July of '86."

[p. 35-206] Q Will narrow the gap?

A From whatever it was at the existing time.

Q Right. And that was the discussion and that was Mr. Sandefur's suggestion, wasn't it?

A It's under his initials, yes, sir.

Q And that means he said it?

A To the notes, yes, sir.

Q No. He said it to the group?

A To my best memory from what I see here in the notes.

Q He said it to the group?

A Yes, it was discussed in the meeting.

Q Would you look down here again where it says, "T. E. S. suggests" and it says, "take pricing \$1.50." Do you see that?

A Yes, sir.

Q That means \$1.50 a thousand, doesn't it?

A Yes, sir.

Q Okay. And up above there, Mr. Sandefur said, "75 cents on 1/86 and 75 cents on 7/86," and that comes to \$1.50 a thousand, doesn't it?

A Yes, sir.

Q A thousand cigarettes is what we're talking about, right?

A Yes.

Q And then if you would go down at the bottom to "Rationale," it says, "bought GPC," correct?

[p. 35-207] A Yes, sir.

Q And that's, again, under "Mr. Sandefur's suggests," isn't it?

A It has another underline; it appears to be under the same section.

Q Okay. And then it says at the end of that sentence, "Hold volume as strategy to manage share of generics." That was again Mr. Sandefur, wasn't it?

A It appears to be, yes, sir.

Q Now, Ms. Olges, when we talked about narrowing the gap - Mr. Sandefur said he wanted to narrow the gap; that refers to the fact the price increase he was discussing would narrow the price differential between generics and full-price brands, isn't that true?

A Yes; to my understanding that's what the reference in the notes mean.

Q So what Mr. Sandefur was telling the group and suggesting and recommending was that Brown and Williamson's plan in its five-year plan was to reduce or narrow the price gap between full margin branded cigarettes and generic cigarettes, isn't that true?

A No, sir. What was recommended was a price increase by B and W that would mathematically have that result. The recommendation and the decision was on B and W's prices.

Q I understand that, Ms. Olges, but the point is he was [p. 35-208] suggesting to narrow the gap. That's what he says ---

MR. NORWOOD ROBINSON: I object, sir. He's asked the question and she's answered it, I respectfully submit, sir.

THE COURT: Overruled.

BY MR. TOPMAN:

Q Mr. Sandefur said and suggested narrow the gap?

A He suggested a price planning; the result by calculation would be narrowing a gap, that he ---

Q And when he ---

MR. MICHAEL ROBINSON: Would you let her finish, please?

A The suggestion and the plans were on the pricing policy; that B and W can control the prices of its own products, and that's how I remember the discussion.

Q You remember the discussion now?

A No; I'm saying these notes --- that the discussion of 75 cents is a price increase.

Q And it will narrow the gap on generics, isn't that right?

A That's the result.

Q And that's what he said?

A There was a statement, yes, that is the result if the prices are raised that way over the five - over the five-year period.

Q And that was a statement by Mr. Sandefur, right?

[p. 35-209] A Yes, sir.

THE COURT: Any more on this document?

MR. TOPMAN: Yes, sir.

THE COURT: More than one or two?

MR. TOPMAN: Yes.

THE COURT: All right. Well, we'll take a break until 9:30 tomorrow morning. Ladies and gentlemen of the jury, tomorrow is Friday and we will take our mid-afternoon break on Friday and recess for the weekend at mid-afternoon on Friday, tomorrow. Until that time remember what I have instructed you previously, and we will see you again at 9:30 tomorrow morning.

All right, Marshal.

(Jury out at 5:00 P.M.)

THE COURT: All right. You may come down, Ms. Olges.

Let's see where we are. Roughly, how much longer do you think you'll be with this witness? I'm not trying to rush you; I want to move it on. But I'm just trying to see whether we're going to finish this witness tomorrow.

MR. TOPMAN: I believe we can finish the witness tomorrow, Your Honor.

THE COURT: On your part, I assume, but I mean what – do you think you will finish mid-morning or before lunch tomorrow?

* * *

[Excerpt Of Trial Testimony Of D. Jackson]

[p. 39-214] Q What effect, if any, did B and W's volume rebates of the type that you've just described have on Liggett and Myers' position in the market?

MR. MICHAEL ROBINSON: Objection.

THE COURT: Overruled.

A It was a lose/lose situation for us. If we didn't pay the incentives, we lost the volume. If we paid the incentives, it took a tremendous amount of money that we really couldn't afford. So it was lose/lose either way we went.

Q Now in connection with your franchise program, what was the highest bracket in your franchise program for them to earn the 13 cents?

A Five hundred cases per quarter.

Q How did that compare to the Doral volume actuals – what you've described as volume pricing?

A That was also five hundred cases per quarter.

Q Now drawing your attention to Plaintiff's Exhibit 4412A --- I don't know. Can you – let me give you a small copy of it so you can see it better. When B and W first entered the generic cigarette business, what was B and W's highest volume category?

A When they first came into the market, it was 1,500 cases per quarter.

Q Now you say it was 1,500 cases per quarter even though

* * *

[p. 40-9] THE COURT: All right. They are admitted also.

(The documents above
(referred to were received
(into evidence as:

(PLAINTIFF'S EXHIBIT
(NOS. P-3291, P-4079,
P-3310, P-4081, P-3376,
P-4082, AND P-4369.

THE COURT: All right. Mr. Foster?

MR. FOSTER: Thank you, sir.

DAVE JACKSON, PLAINTIFF'S WITNESS,
PREVIOUSLY SWORN
DIRECT EXAMINATION (CONTINUING)

BY MR. FOSTER:

Q Mr. Jackson, I'd like to direct your attention to the time period of June 1985, and do you recall whether or not Liggett and Myers increased the list price of its generic cigarettes at or about that time?

A Yes, we did increase our list price.

Q Why did you increase the list price?

A We had to increase the price to be able to meet the competitive incentives that ---

MR. NORWOOD ROBINSON: Sir, I'm awfully sorry, but I have trouble hearing. Excuse me, Your Honor.

THE WITNESS: I'm sorry.

A Yes, we did increase our price in June of 1985. It was necessary - we were forced to do it - we just had to do it to be able to have enough funds to meet - to stay in the [p. 40-10] incentive battle.

MR. MICHAEL ROBINSON: Motion to strike.

THE COURT: Overruled.

BY MR. FOSTER:

Q Could you not have just decreased the rebates rather than increase your list price in order to take care of that financial situation?

A No, sir. If we had gotten out of the rebate war, we would have been out of business immediately.

Q Mr. Barker has handed you Plaintiff's Exhibit 16, which is already in evidence. What is that document, Mr. Jackson?

A That's B and W Heartland's generic cigarette program.

Q Now the front of the exhibit has a date on it. Could you please read that?

A It's June 4th, 1984.

Q Now, sir ---

MR. FOSTER: Can you show that, please? The date up at the top.

BY MR. FOSTER:

Q Please turn to Page 1 of this Heartland generic cigarettes document. I believe up at the top it has the heading, "Introduction"; is that correct?

A Yes, sir.

Q Now Please read the first sentence under the graph.

A "The generic segment continues to grow and expand."

* * *

[p. 44-41] Q In your opinion, did it hurt the growth of black and white generics, sir?

A No, sir.

Q I want to show you, sir, a document dated - numbered Defendant's Exhibit 1038, dated February the 20th, 1985. Would you read it for us, please, sir the first - See that first bullet?

A Yes, sir.

Q Read to me that second paragraph there, sir. It starts, "Doral."

A "Doral, a direct price competitor to generic, grew from a .3 share in July to a .7 share in December. Doral has probably hurt the growth of generic sales."

And, sir, I certainly agree with that. Generic was growing at a very rapid pace, and Doral came in. Generic continued to grow, but the growth probably wasn't at the level that it would have been if Doral hadn't of come into the market.

Q Sir, this is a memorandum - a printed sheet of paper having to do with Stride cigarettes, doesn't it sir?

A Yes, sir.

Q And that was the cigarette that you put into the market in 1983 or '84 in the value for money segment?

A Yes, sir. It was in the mid-price.

Q Would you look, sir, down in the lower left-hand corner

* * *

[p. 44-108] percent and a \$1.00 per carton spread between the price of generics and branded cigarettes. Is that right?

A Yes, sir.

Q I want to show you a price spread chart for 1984 and '85 which shows the spread got bigger on a dollar percentage basis in '84 and '85, if I may, please, sir.

This document ---

THE COURT: Is this in evidence?

BY MR. NORWOOD ROBINSON:

Q Sir, are you familiar with this document, this board right here, 9007?

THE COURT: Is that a Plaintiff's Exhibit?

MR. NORWOOD ROBINSON: Yes sir. No. I'm sorry, sir. It's Defendant's Exhibit 9007. I apologize.

A Sir, I've not seen it before, if that's your question. No, sir.

BY MR. NORWOOD ROBINSON:

Q Do you know whether or not the figures on it are correct, sir, that reflect the price spread between cigarettes? You're not familiar with this at all?

A It appears --- Yes, sir. That appears to be correct or close to correct.

Q Were you in the courtroom when this was testified to, sir?

A No, sir. I was not. I have not seen that.

* * *

[p. 44-116] prices, if my memory serves me right, up to the four twenty-six either.

So instead of being at 24 percent, it was closer to 40 percent, as you just pointed out in your chart.

Q Mr. Jackson, do you remember testifying, sir, that you had computed the dollar savings between generics and branded cigarettes, based on Liggett's volume, to be about 375 million dollars between 1980 and mid-1984?

A Yes, sir. I remember that.

Q Did you do that computation?

A Yes, sir. I had it done, and I ---

Q I didn't ask you whether you had it done or not. I asked you if you had done it.

A Yes, sir. I had a hand in doing it.

Q Well, who did it, sir?

A I had some of our people here to do it, people who had the financial capabilities, the number capabilities of doing it. And I had a hand in doing it.

Q Well, did you actually made some of the computations?

A I worked with them on the approach that would be taken in figuring it out.

Q Well, what did you tell them to do as far as the way that you were going to work it out?

A To look at what branded prices sold for or what the price was on branded and what the price was on generic. And [p. 44-117] it pretty well had to be done by quarter because of the price increases that took place during those periods of time.

And to total up the amount of difference there was between the list price on branded and the list price on generic for that period of time.

Q The wholesale list price?

A Yes, sir.

Q And I believe you told us, sir, that you figured that 70 percent of that amount of money would have wound up in consumer savings.

A I say in excess of \$300 million. And frankly, I didn't figure out the percentage. But yes, sir. I said in excess of \$300 million.

Q You didn't tell us, sir, that 70 percent of those savings ended up at the retail level?

A I possibly could have said 70 percent, but I specifically remember saying in excess of three hundred million.

Q Well, sir, isn't it true that the savings totaled almost \$3.5 billion if you compute it since Brown and Williamson got in the market?

A The category has grown at a very rapid pace ---

Q Could you answer my question?

A Yes, sir. Yes, sir. You're exactly right. And, sir, it has grown at a very rapid pace to where, as you pointed [p. 44-118] out earlier, it's a 15 share of market.

I would also like to point out, though, if we hadn't have [sic] gotten in this incentive battle that we're in and so forth, it could have very well been like military. Instead of being a 15 share of market, it would have been a 26, which would have been a whole lot greater than that.

Q Sir, the truth of the matter is that the savings to the consumer has been almost eight times as much during the period of time since Brown and Williamson got in the market and it became more competitive than the savings were during the time when you had it by yourself.

A Yes, sir. That is exactly right. And again, I repeat, it would have been a whole lot greater if we hadn't have [sic] got tied up in all this that we're tied up in. It would be like the military which could be probably in excess of five or six billion dollars.

Q You're aware, aren't you, that some time around July of 1985 that GPC decided to have Brown and Williamson manufacture cigarettes under the GPC name instead of Liggett? Right?

A Yes, sir. I'm aware that somewhere in '85 that Brown and Williamson bought GPC's label.

Q You're also aware, aren't you, sir, that Liggett went to customers who had previously bought GPC cigarettes and tried to get them to buy other brands other than GPC?

* * *

[p. 45-15] You understood that, did you not, sir?

A I think the document said that Brown and Williamson had been held out or blocked out of the Kansas City market.

Q And all I was doing was quoting what the document said, wasn't I, sir?

A You had me read the document, yes, sir.

Q All right, sir. Now your salespeople simply reported how successful they had been in Kansas City and Nashville in holding Brown and Williamson out, which means that Liggett had almost all of the business, doesn't it, sir?

A Yes, sir, it would. Until B and W came in the market, we were in the market exclusively with generics.

Q Yes, sir. But you had been successful for several months after B and W got in to almost keep them out of the market, hadn't you, sir?

A No, sir. Within the first two to three weeks after B and W came into the marketplace, they had sold 900 customers and it was 900 of the largest ones around the country.

Q Isn't it a fact, sir, that in the first four months of 1985 Liggett sold over 15 times more generic cigarettes at Liggett than B and W did?

A That is certainly possible. But again, within the first three weeks that B and W was in the marketplace, they had sold 900 customers, which projected to be 3.6 billion for the [p. 45-16] remainder of the year.

Q I want you to look, sir, at Defendant's Exhibit Number 1309 for me. Now this document is dated June the 27th, 1985, and it is form Didi Hunt to Mr. Cohen - Mr. Steve Cohen, right?

A Yes, sir.

Q And it indicates the middle of June 1985 that the latest information showed what the sales were in various markets in the United States, doesn't it, sir?

MR. FOSTER: Objection, Your Honor. I don't think we covered this on redirect.

THE COURT: Well, we're talking about in connection - follow-up on the Kansas City-type question. Overruled.

MR. NORWOOD ROBINSON: Yes, sir.

BY MR. NORWOOD ROBINSON:

Q I want you to look sir - this document says that it was necessary to combat the situation, doesn't it, sir, the third and fourth lines of the second paragraph? Do you see where it says, "I have highlighted the more exaggerated areas and would like to consider working retail headquarters ---"

A Yes.

Q "--- with both Liggett and Gary people in those areas to get a feel for what we can do to combat the situation"?

A Yes, sir.

* * *

[Excerpt Of Trial Testimony Of L. Butler]

[p. 46-54] Q "For the record, referring to the sentence in the top paragraph of Page 4 of the document bearing production number 129925."

A "That's ---"

Q "That's what?"

A "That's the objection that I had, or the disagreements with the document."

Q "In 1984, do you recall that Brown and Williamson sold 2.2 billion units of generic cigarettes?"

A "Yes."

Q "Was that the target that Brown and Williamson had set for generic sales for 1984?"

A "Yes. Well, two billion was the target."

Q "So Brown and Williamson was over its target in 1984?"

A "Oh, that's correct."

Q "Let me show you what has been previously marked as Plaintiff's Exhibit 15---"

MR. FOSTER: Which is Tab 3 in your binder.

Q "--- and ask if you can identify that document."

A "Do you want to know if I recognize this document?"

Q "Yes."

A "Yes. I do."

Q "Is the typed portion of that document a memorandum that you received from Mr. Christensen?"

A "Yes."

* * *

[Excerpt Of Trial Testimony Of W. Burnett]

[p. 46-165] [A] . . . States, such behavior is not plausible because the firm that engages in the predatory behavior is unlikely ever to get the money back. Because if they do succeed in causing a firm to reduce or diminish its competitive initiatives, and it costs them money, as soon as they turn around and try and get the money back, when they try and recoup it, they're effectively raising the price of the product that they manufacture and sell.

And in most industries, in most markets, as soon as the competitor attempts to raise the price above the level being charged by the other manufacturers, the firm will lose a substantial quantity of its sales to its competing manufacturers and will never be able to get the money back.

So the first step for me as an economist, in carrying out this type of analysis, was to make an assessment of whether predatory behavior likely made sense. Whether you could ever expect to get the money back if you decided to spend it to discipline a rival.

Q Now, Mr. Burnett, you referred to the necessity of a predator to get his money back plus a little more. Is that what you mean by this word "recoupment" and predatory investments plus something else?

A That's exactly right. If you spend money, if you invest money to discipline a rival, you have to recoup that money. You've got to get it back. If you can't get it back, if you [p. 46-166] can't recoup your losses, then the effort doesn't make sense. Now that doesn't mean that firms won't try it every once in a while and make a

mistake and not be able to subsequently recoup, but rational predatory behavior, predatory behavior that makes sense on the part of the firm engaging in the predatory conduct, has to be predicated on the anticipation of getting that money back plus a little more.

Q Now, Mr. Burnett, what information have you reviewed and considered in conducting these analyses?

A Quite a lot, Mr. Hogeland. I have read a number of industry studies and histories of the cigarette industry that stretch back to the turn of the century. I have interviewed executives at the Liggett and Myers Corporation on a number of occasions. I took a plant tour of the Liggett and Myers cigarette factory. I toured a leaf processing facility that takes tobacco leaf and puts it in a form that can subsequently be used to make cigarettes.

I read large volumes of documents and depositions that were produced or elicited in the process of this litigation over the past four years. I have reviewed an extensive quantity of publicly available information from both the Federal Government and from newspapers and magazines and from stock brokerage houses or securities analysts, and I have consulted on a fairly regular basis with Dean Thomas Keller of the Fuqua School of Business at Duke University with . . .

* * *

[p. 46-168] A Yes it is.

Q Now, Mr. Burnett, before you talk in detail about each of your five areas of analysis, could you tell us on your Industrial Organization Analysis, what conclusion,

if any, you reached about whether or not predation in the cigarette industry made sense or was plausible?

A I concluded that predatory behavior on the part of one of the larger cigarette manufacturers in the industry with respect to Liggett and Myers did make sense and was plausible. It is my opinion that prices charged for branded cigarette products exceed the level that would exist in a fully and effectively competitive market.

What that means is that Liggett's introduction of generic cigarettes and low prices and at low margins, and the fact that those low margin and low price cigarettes took sales away from high priced branded cigarettes, had the effect of diminishing the profitability of the larger branded cigarette manufacturers. And it's precisely the fact that Liggett was having the effect of reducing industry prices and causing the larger manufacturers to lose sales of high priced, high margin, high profit cigarettes that provided the incentive for Brown and Williamson to engage in the conduct it subsequently engaged in.

Q Well, Mr. Burnett, without stating your opinion as to Brown and Williamson's intent in entering the generic [p. 46-169] segment, did you come to a conclusion as to whether or not Brown and Williamson's plans for entry, if implemented, could injure competition?

A Yes, I did.

Q And what was that conclusion?

A I concluded, based on my evaluation of their documents, that their corporate documents clearly demonstrate ---

MR. LONDON: Objection, Your Honor.

THE COURT: All right. Sustained to the phrasing of what they demonstrate, but tell your conclusion from what the documents say that they did.

THE WITNESS: I'm sorry, Your Honor. I don't think I understand.

THE COURT: All right. I can understand some confusion there, but when you start talking about what they demonstrate, you're getting close to talking about intent. And intent is going to be a question for these jurors over here.

Now he has asked you if you have reviewed Brown and Williamson's plans for entering the generic market, and you said that you had. And he may ask you more about that.

But, Mr. Hogeland, why don't you try to ask it in a way other than what the documents demonstrate, something to the effect of what the facts are or how they entered. You can rely on the documents as to stating how they entered and what

* * *

[p. 46-171] THE COURT: No, sir. That's the point. You can't testify what they intended. You can testify what they did and what the result would have been if they did what the document said they were going to do, or that they did.

A I concluded that if Brown and Williamson carried out the plan that was described in their documents in 1984, that that program would have had a harmful effect on competition and would have harmed Liggett and Myers.

BY MR. HOGELAND:

Q Now, Mr. Burnett, you said the third area of analysis was prices and costs. What, if any, conclusion did you reach regarding B&W's pricing of its generic cigarettes [sic]?

A I concluded that for the period that I had data for, which ran from mid-1984 through December of 1985, Brown and Williamson priced its generic cigarettes below average variable cost, and that to me, as an economist, I believe that demonstrates their predatory intent in entering the generic cigarette category.

Q Mr. Burnett ---

MR. LONDON: May I have that answer stricken, Your honor? The second part about what he believes that fact yielded as to his view of Brown and Williamson's intent.

THE COURT: All right. Ladies and gentlemen of the jury, you will disregard the witness's testimony as to what their documents or pricing policies demonstrated, and you may. . . .

* * *

[p. 46-198] soon as they stopped investing in the predation and stopped disciplining their competitor, they'd have to try and raise the price of their own carpet in order to make up for the predatory behavior. And as soon as they try and raise the price, that carpet manufacturer is going to begin losing lots of sales to both other manufacturers of carpet, but also other manufacturers of vinyl floor covering and other manufacturers of wood flooring

and other manufacturers of tile and terazzo and anything else you can put on the floor.

So the firm, in carrying out the predatory campaign, doesn't have a reasonable possibility of ever getting the money back in that setting. That's a situation in which predatory behavior is extremely unlikely to make sense or be plausible.

Q Mr. Burnett, what factors in the cigarette industry did you look at to determine whether or not predation in the cigarette industry by Brown and Williamson would make sense?

A Well, again I broke my analysis into a number of general categories. In fact, there are six of them. The first one has to do with the number of manufacturers of cigarettes and the degree of concentration of sales among the manufacturers of cigarettes. The second has to do with the pattern of list price changes and the actual list prices charged for cigarettes. The third has to do with the relationship between changes in the cost of manufacturing cigarettes and changes in the prices charged for cigarettes which may or may not make sense or occur in a competitive market. The fourth involves an evaluation of the actual profitability or the accounting rates of return earned by the cigarette manufacturers. The fifth involves an evaluation of conditions of entry into the cigarette market, or a determination of how easy or difficult it would be for a new manufacturer to begin manufacturing cigarettes. And the final category involves the role – the specific role that Liggett and Myers has played in competition and in the determination of cigarette prices in this

industry over the last ten to twelve, perhaps, thirteen years.

Q Now, Mr. Burnett, these six factors that you've identified, are they factors that are commonly considered by economists in industrial organization market analysis?

A Yes, sir, they are.

Q Looking at the first factor that you analyzed, what does an economist mean by "market concentration"?

A Well, market concentration is a fairly straightforward concept. It simply measures the share of total industry sales controlled by the largest manufacturers. There are really two issues going on in this portion of my analysis. The first has to do with the number of competitors there are, and the second has to do with the extent to which the larger competitors control the bulk of the sales in the industry.

Q Why is the number of firms in the market and the degree [p. 46-200] of market concentration important to an economist in conducting an industrial organization market analysis?

A Well, both features – the number of firms and the level of market concentration – are key aspects – are key features of the structure of any industrial market. And the principal concern here is that when you have many, many firms in an industry – for example, in carpet and floor covering – no single firm has the ability, unilaterally, to change or affect the market price. If they try to raise the price, there are so many competing manufacturers

that they'll lose a lot of sales, and their attempt to raise the price won't be profitable.

However, economists have long recognized that when there are only a small number of competitors, and when sales are concentrated in the hands of a small number of competitors, that those firms may, in some circumstances, be able to tacitly coordinate their behavior and approximate the pricing result that would occur if there was just a single firm monopolist [sic]. That's very important.

To an economist, the evil of monopoly [sic] – the harm to the consumer that results from monopoly [sic] is that prices are held above levels that would prevail if there was lots and lots of effective competition in the market. And the importance, again, of concentration is that when there are only a small number of firms and concentration levels are high, that in [p. 46-201] some circumstances those firms may be able to behave as if they were a single firm monopolist [sic] and raise the prices charged to the consumer. That hurts the consumer.

Q What is wrong with monopoly pricing, to you as an economist?

A Well, there are two aspects to that. First, the consumer has to pay more than the consumer would pay if there was full and effective competition in the market. And there is a more technical criteria which points out that if the price is raised and fewer cigarettes will be sold, and that results in something called the "welfare loss," or a loss in resources to society, because society and the consumer of cigarettes is paying more than they need to. And if the price fell, more cigarettes would be smoked.

And that is the socially optimal combination of price and output. It's down here at the competitive level. It's not up here at the monopoly level (demonstrating).

Q As an economist, what do you mean by effective competition?

A Well, one has to be practical and realistic. Pure and perfect competition is a model that economists sometime set forward which involves having literally hundreds of competitors, none of which have any influence or control over prices. On the other hand, when you get to an industry like the cigarette industry, where there are only six [p. 46-202] manufacturers of competitive significance, one has to set standards that are reasonable to impose on those six manufacturers. They have to realize that competitive initiatives taken by one will have a direct recognizable cognizable affect on its rivals. And the hope is that the firms will compete vigorously and rivalrously with respect to one another, and not coordinate their behavior.

The principal fear is that when there are only a small number of firms, the firms will in fact adopt forms of business conduct which will be more akin or more similar to those that would prevail if there was only a single firm selling the product.

Q Do economists have a term that they use to identify situations in which a group of firms approximate the pricing behavior of a monopoly?

A Yes, there is.

Q What is that?

A Well, there are two phrases that are used, essentially interchangeably. One is "monopoly [sic] power," and one is "market power." And both mean that either the single-firm monopolist or the small group of competitors acting tacitly, without ever getting together, may be able to raise prices above the competitive level and approximate the result of monopolist. Monopoly power, market power, I use them interchangeably. I think most economists do.

[p. 46-203] Q What do you mean when you use the word "tacit"?

A I use the word "tacit" very carefully to distinguish it from overt collusion or overt coordination of firms' behavior. Overt coordination and collusion would involve, for example, getting together in a motel room - two carpet manufacturers getting together in a hotel room and saying, "Let's all raise our price." That's overt collusion, that is absolutely barred under the anti-trust laws. And I use tacit collusion, tacit coordination in distinction from that.

Firms may be able, solely, without ever getting together, without ever meeting in that hotel room, to coordinate their behavior and raise prices and get prices above levels that would prevail in a competitive market. Now you don't have to meet in order to do it. And it's those circumstances in which actual meetings do not occur that are what I mean by tacit coordination or tacit collusion.

Q Do economists have a word, Mr. Burnett, to describe an industry where there are a small number of firms?

A Yes. It's an awkward word for a simple concept. It's called oligopoly. An oligopoly is just the term we apply to an industry where there are a small number of competitors. And the key feature of an oligopoly, to an economist, is precisely that actions taken by one firm in that market will have direct and recognizable effects on its rivals and its competitors. That's to be contrasted [sic] - let's use wheat [p. 46-204] farmers.

If one wheat farmer tries to do something and raise its price, there are so many thousands of wheat farmers in the United States that its neighbor next door is never going to notice the fact or the effect that his attempt to change the price will have. That's a competitive environment. Oligopoly is a small numbers environment where the behavior of each firm has an effect on its rivals.

Q Well, Mr. Burnett, doesn't an oligopoly or an industry with a high level of market concentration or an industry with a high level of market concentration always mean that there is coordination of prices or monopoly pricing or market power for tacit collusion?

A No, sir, not at all. Successfully coordinating behavior tacitly, without ever getting together is tough. It's difficult and, in my view, doesn't occur very frequently. However, it is a predicate or a precondition that has to occur before firms - without getting together - will or may be able to coordinate their behavior and raise prices. It doesn't necessarily lead to high prices, but it is a condition significantly enhancing the ability to raise prices and get the price up to something approximating the monopoly result.

Q Well then, what is the significance of market concentration to you as an economist in your industrial [p. 46-205] organization market analysis of the cigarette industry?

A It is the first step. It is the predicate. Establishing that there are only a small number of competitors and market concentration is high provides the groundwork or the context where then the firms may be able to raise prices. It doesn't say that they'll actually achieve it, but it says they may be able to do it. They may be able to get away with it. So it's just the first step.

Q What do you mean by predicate?

A First step. It's the starting point.

Q Well, Mr. Burnett, how many firms are there in the cigarette industry?

A There are only six firms of competitive significance. There, over the last ten years, have been a couple of very small firms and manufacturers who also distributed cigarettes, but in my view, they played no material role in competition in the industry.

Q Now who are those six firms, Mr. Burnett?

A They include Philip Morris, R. J. Reynolds, Brown and Williamson, American Tobacco, P. Lorillard, and Liggett and Myers.

Q In your experience as an economist, is that a small number or a large number of firms?

A Well, there are certainly industries and markets where there are fewer than six firms or where there are

six firms, [p. 46-206] but in my experience, it is a small number, and it is a number, which standing on its own, raises the possibility that the firms in the industry may be able to coordinate their behavior.

Q Well, now, in addition to the number of firms you refer to the level of market concentration. How do economists measure the level of market concentration?

A Well, there are a number of ways you can go about evaluating market concentration. There are two standard measures. One involves very simple arithmetic which says that you take the market share of the leading four firms and add them up, and that gives you the four-firm concentration ratio. All that tells you is what proportion of total industry sales are in the hands of the four leading manufacturers. The other standard measure of concentration which economists typically rely on today has a long name that doesn't mean much. It's called the Herfindahl-Hirschman Index, and it is simply an algebraic manipulation of the market shares of all of the firms in the industry rather than just the four largest.

Q Well, Mr. Burnett, did you cause an exhibit to be prepared showing the market concentration in the cigarette industry?

A Yes, I did.

Q I show you Plaintiff's Exhibit 4062R, and I ask you if [p. 46-207] that is that exhibit?

A Yes, it is.

MR. HOGELAND: Your Honor, I offer 4062R in evidence.

MR. LONDON: No objection.

THE COURT: Admitted.

(The document above
(referred to was received
(into evidence as:

(PLAINTIFF'S EXHIBIT
(NO. 4062R.

MR. HOGELAND:

Q Now, Mr. Burnett, can you tell us where you got the information - the source of the information - the theory on Exhibit 4062R?

A This data was derived from the Maxwell Reports. I believe these have been discussed previously in the trial. Mr. Maxwell collects data on the cigarette shipments four times a year, every quarter, and compiles it and then publishes it and distributes it to the manufacturers and to the public at large. And this data was derived from the 1982 Maxwell Report.

Q And can you tell us --- You have a line on there called "Four-Firm Concentration." Can you tell us how you got that number?

A Yes. If you look in the farthest right-hand column of [p. 46-208] data, under the heading, "Market Share," you have market shares for each of the six manufacturers and if you just add up the market shares for R. J. Reynolds, Philip Morris, Brown and Williamson and American, the sum of those market shares will be the 88.4 that is displayed down underneath in the first line of data underneath the tally for each firm.

Q And then the four-firm concentration ratio, is as simple as that? You simply add up the percentage market share of the top four firms? Is that right?

A Yes, it is.

Q And is it true, Mr. Burnett, that the higher the four-firm concentration ratio in an industry, the higher the degree of market concentration?

A That's correct.

Q Now you mentioned another measure of concentration levels relied on by economist which is the Herfindahl-Hirschman Index. And what is that, Mr. Burnett?

A Well, the Herfindahl-Hirschman Index is simply another calculation based on this same set of data. If you take the market share that is displayed in the far right-hand column for each company and multiply it times itself or square it, so that for R. J. Reynolds you would be taking 33.4 times 33.4, you get a number - you get the squared number, and I've done that, and it's 1116, and what you do to calculate the Herfindahl-Hirschman Index is carry out that procedure or [p. 46-209] square each of those company market shares and then add them all up the same way you did the four-firm concentration ratio, and the only difference here is that you add the Herfindahl-Hirschman Index for all six manufacturers rather than just the four leading ones. So if you squared each of these market shares and summed them up - added them all up, you would come out with the number displayed down here on the second line underneath the table, the Herfindahl-Hirschman Index of 2,532.

Q So your calculation of the Herfindahl-Hirschman Index that appears on Plaintiff's Exhibit 4062R is also based on the same 1982 Maxwell Report. Is that correct?

A Yes.

Q Now, Mr. Burnett, why did you use the 1982 Maxwell Report?

A Well, the fact is, Mr. Hogeland, that it really doesn't matter which year you choose. I selected, for purposes of illustration, 1982 because there is a comprehensive set of data compiled by the federal government, specifically by the Department of Commerce and the Bureau of the Census. It is called the Census of Manufacturers. It's collected by the Bureau of the Census every five years. 1982, 1987 - it would be collected again in 1992, and at the time this table was prepared, and indeed last week, the data for 1987 was not yet publicly available and had not been published, so since there

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[p. 46-212] manufacturing firms in the United States and, again, that occurs every five years.

Q Well, what industries did you use to compare with the cigarette industries to determine whether or not the levels of concentration in the cigarette industry were high?

A I used two samples. The first sample is that I did a general review of all of the, roughly, 350 industries reported in the Census of Manufacturers to determine, generally, how many had levels of concentration that reached the level that prevailed in the cigarette industry. I then prepared, specifically, tables and computations of

levels of concentration in industries that were classified as producing either food and related products or tobacco products. So, I looked generally at the Census of Manufacturers overall, which has a very, very large sample of industries and then I looked more narrowly at food and kindred - or food and related products - and tobacco products with more specificity.

Q And what did you find when you compared the levels of concentration in the cigarette industry with the total spectrum of some 350 different industries?

A Well, in either test or, as I put it, with either screen or measure against which we want to judge this, there are some industries that are somewhat more concentrated than cigarettes but, in general, cigarettes remain one of the most [p. 46-213] highly concentrated industries in the United States. There are few industries that reach this level of concentration.

Q Well, now, you also said you compared it with a selected group of industries that you identified as food and related products. How many industries are in the Census of Manufacturers that are called "Food and Kindred Products," Mr. Burnett?

A If you combine the broad category of food and kindred products or food and related products with the four industries that are classified as tobacco industries, there are approximately 50 industries in those two classifications.

Q Well, why did you choose the food and kindred products selection of industries in which to make your comparison?

A Well, it really didn't matter. Again, as I said, even if you look at the entire sample of manufacturing industries throughout the United States, there aren't that many proportionately that have levels of concentration that reach the level that exists in the cigarette industry. However, the manufacture and distribution of cigarettes is more similar to - more akin to - the manufacture and distribution of food and related products and other tobacco products than it is, for example, with the manufacture and distribution of copper or steel or automobiles, so I selected food and kindred products because it was generally more representative and similar to tobacco than were many of the [p. 46-214] other industries for which data is compiled.

Q How does the cigarette industry levels of concentration compare with the levels of concentration in the food and kindred product industry?

A Well, whether you rely on the four-firm concentration ratio or the Herfindahl-Hirschman Index measure of concentration, both of which are reported by the Census of Manufacturers, the cigarette industry is one of the most highly concentrated industries among the 50 or so industries reported in those two categories.

Q Are there industries in those two categories with higher levels of market concentration than cigarettes?

A One or two.

Q Do you know what they are?

A Well, if memory serves, chewing gum is one. Breakfast cereal is one that is roughly or approximately as concentrated as cigarettes, and chewing and smoking

tobacco is also highly concentrated. If memory serves, depending on the measure of concentration, there may be one or two more, but out of the 50, there are very few with levels of concentration by either measure that come close to that prevailing in the cigarette industry.

Q Now, Mr. Burnett, you mentioned that your third screen was the Department of Justice guidelines. What are the Department of Justice guidelines?

* * *

[p. 46-223]

(The document above
(referred to was received
(into evidence as:

(PLAINTIFF'S EXHIBIT
NUMBER 4061.

BY MR. HOGELAND:

Q What does Plaintiff's Exhibit 4061 list as an unconcentrated Herfindahl-Hirschman Index, Mr. Burnett?

A It names as an unconcentrated market an industry with a Herfindahl-Hirschman Index of less than 1,000 points. That 1,000 points would be comparable to the 2,532 that appeared on the earlier exhibit about the cigarette industry.

Q And what does the Department of Justice Merger Guidelines list as the Herfindahl-Hirschman Indices for moderately concentrated industries?

A They consider markets with concentration in the range of 1,000 to 1,800 Herfindahl-Hirschman points as being moderately concentrated industries.

Q And what does the Department of Justice Merger Guidelines list as highly concentrated industries in terms of the Herfindahl-Hirschman Index?

A If the Herfindahl-Hirschman Index exceeds 1,800 points, that industry is considered highly concentrated.

Q And what is the Herfindahl-Hirschman Index for the cigarette industry, Mr. Burnett?

A In 1982 as presented on Exhibit 4062R it was 2,532, and [p. 46-224] by 1988, it was measured from the same source, the Maxwell Reports. It had risen to almost 2,800 points.

Q Well, Mr. Burnett, what does the high level of market concentration in the cigarette industry indicate to you regarding competition in the cigarette industry?

A Well, once again, it is the first step in establishing that the firms in this industry may be able to tacitly [sic] coordinate their behavior and approximate the result of a monopolist. That means that they will be able to raise prices above competitive levels.

Q And what does this high level of concentration mean to you as an economist regarding whether or not it would make sense or be plausible for Brown and Williamson to engage in predatory conduct towards Liggett and Myers?

A If the firms in the industry are able to raise prices above competitive levels – and this is the first step in evaluating whether they can – if prices are above competitive levels then the larger manufacturers and in particular, Brown and Williamson, may have high prices and high profits to protect or defend in engaging in predatory

behavior with respect to Liggett and Myers who was introducing low price, low margin products, and causing the average price of all cigarettes sold in the United States to be reduced and to benefit the consumer.

Q Well, you said earlier, Mr. Burnett, high levels of

* * *

[p. 46-226] manufacturers manage to avoid competing with respect to list price. It's one key competitive variable that says they are not competing, and an evaluation of list prices was the second step I embarked upon, or the second step I took in evaluating the plausibility of predatory behavior in the cigarette industry.

Q Well, are prices and patterns, price changes, a subject that economists would normally look to in doing an industrial organization market analysis?

A Yes. It is an issue that has been a subject for analysis for decades – standard tool for analysis.

Q What do you look at to evaluate changes in list prices and patterns of list pricing?

A If I understand your question, I look at the actual list prices.

Q Well, what did you look at in evaluating changes and list prices in the cigarette industry?

A There were several pieces of evidence or information that bore on that. In particular, there has been quite a bit of testimony here in court by Mr. Grant, by Mr. Dey, by Mr. Jackson, and I believe, by Mr. Sandefur, that the cigarette companies tend to change their list prices at about the same time by about the same amount in a

regular manner. So that one large manufacturer – one of the larger manufacturers will raise the price and within, say, two weeks to a month, all of [p. 46-227] the other manufacturers have managed to raise their list price to essentially the same level. This kind of block-step pricing where everybody goes up by the same amount at the same time regularly, now twice a year, mid-year and the end of the year, came out clearly in the testimony. Virtually, everyone who was asked – I'm sorry. Not virtually. I believe everyone who was asked about it testified to the same pattern of list price changes. So that was one piece of evidence I looked at.

There are also documents that were secured from the Brown and Williamson Corporation, which actually traced the history of list price changes going back many years. Documents I had available to me traced the pattern of list price changes from 1966 forward to, I believe, about 1982. And then there was another document detailing a round of list price changes at the end of 1984 and into early 1985. And ---

Q Are you referring to Plaintiff's Exhibit Number 1574 and 796?

A Yes, sir. Plaintiff's Exhibit 1574 is the longer document that presents the history of list price changes as compiled by Brown and Williamson from 1966 forward through 1982 and Plaintiff's 796 presents additional information on the round of price changes that occurred in late 1984 and January of 1985.

MR. HOGELAND: Your Honor, Plaintiff's Exhibit 1574, [p. 46-228] I believe, is already in evidence,

and at this time I would move into evidence Plaintiff's Exhibit 796.

I'm sorry; they're both in. They're both in.

BY MR. HOGELAND:

Q Now does the same company always lead the price increases, Mr. Burnette [sic]?

A No, not necessarily. The leader tends to vary round to round. It tends to be one of the larger manufacturers, Philip Morris, R. J. Reynolds, and I believe, in a couple of instances, Brown and Williamson.

Q Well, what do you mean when you use the word "price leadership"?

A Well, price leadership is a phrase or term of art that was adopted many years ago to describe precisely this kind of block-step pricing – where typically, one of the larger manufacturers will announce a list price increase and the other firms will follow. One leads; the other follows – the others follow. And that's what I have in mind and that's what's described quite clearly in the economics literature.

Q Now are there any other Brown and Williamson documents that you would have used in determining the pattern of list price changes?

A Well, there are a number of documents which get at the same point, but with a little more indirection, not quite as precisely, and they aren't specifically devoted to this [p. 46-229] issue. But, for example, you know, in a fairly extensive Brown and Williamson document with a stamp on it of Plaintiff's Exhibit 1402, that was a Brown

and Williamson Tobacco Corporation CPC or Chairman's Policy Committee presentation. As I understand it, the Chairman's Policy Committee was a committee of BAT Industries, Brown and Williamson's parent corporation in England.

Brown and Williamson put together this big presentation for the CPC in England, and one of the tables in the middle of that document presents average cigarette package or --- Excuse me; cigarette's average price per package by year, and it's labeled "Manufacturer's Price Increase" at specific points in time from 1955 through the mid-1980's. And graphically it shows them effectively all going up at about the same time by about the same amount (demonstrating).

Q Mr. Burnett, what page in Plaintiff's Exhibit 1402 are you referring to?

A It has the stamp number of 194036; it's Chart 11.

Q Is this a copy of that chart?

A Yes, it is.

Q And can you describe to the jury what this heavy black line is?

A Well, that is, as I understand it, the average price per package by year and the little triangles reflect the timing of the price changes and those price changes are labeled [p. 46-230] "Manufacturer's Price Increase," which I take to mean all of the manufacturer's and, indeed, that is generally consistent with the pattern of price changes as reflected in the Brown and Williamson documents I described earlier as chronicling [sic] each of the Brown's price changes for a long period of time.

Q Now, Mr. Burnett, I show you Plaintiff's Exhibit 236 and ask you if you can tell me what that is?

A Plaintiff's Exhibit 236 is a document -- a report compiled periodically that is compiled or -- excuse me -- was compiled periodically by Brown and Williamson called the "Domestic Competitive Analysis" and it contains a great deal of information on each of the manufacturers of cigarettes and a lot of data on market shares and sales and new product introductions and the like. It's basically market research updated periodically by the staff at Brown and Williamson.

Q Is there anything in that document that indicates to you the pattern of list price changes in the cigarette industry?

A Yes, I believe there is.

Q I suggest you look at the last page.

A Thank you.

Q Can you tell us that page number?

A The page number has a stamp of 264467.

Q Is this a blow-up of that page, Mr. Burnett?

A Yes, it is.

Q Can you tell us what this chart shows with respect to [p. 46-231] your analysis of list price changes in the cigarette industry?

A Yes. In January of 1983, there was a doubling in the federal excise tax charged on cigarettes where the tax increased from 80 cents per thousand cigarettes to a

dollar sixty per thousand cigarettes. And what happened was that after they became aware of the anticipated tax increase that would go into effect just after the first of the year in 1983, each of the manufacturers began to anticipate the price or the tax increase and, correspondingly, started raising list prices to cover the tax increase.

MR. LONDON: Objection as to what the manufacturers anticipated, Your Honor, and move to strike it.

THE COURT: All right. Well, unless you have some evidence that you are relying on as to why they did it, you can testify that prices were raised at that time.

THE WITNESS: Yes, sir.

A The prices were raised between August of 1982 and early January of 1983. You can see by looking at the first date line for each corporation that they began raising prices at about August the 26th, with Philip Morris initiating the first price increase. After Philip Morris raised the price in August - on August 26, each of the other firms followed within a period of a couple of weeks and beginning the price change, and what you observe is that although the firms took [p. 46-232] increases at different times and by different amounts between late August and the end of December, by January 3rd of 1983, each of the firms had managed to raise the price by exactly the same amount for king-size cigarettes and hundred millimeter cigarettes.

Q And where did you get that date, January 3rd, Mr. Burnett?

A It's down on the bottom in the second footnote with a double asterisk.

Q Here?

A Yes. Each of those final prices, although they were announced on different dates, became effective according to this document on January the 3rd right after the imposition of the new federal excise tax. So what we have is a window of about five months from August through January of nineteen - August '82 through January of '83 where they raised the price sometimes by different amounts and on different dates, but low and behold, they ended up with the same price and increased the price by the same amount over that long period. So even in the presence of this modest instability in the pattern of list price increases, by the end of the period and precisely when the tax went into effect, they had all raised the price by the same amount and to the same level.

Q Now this is a Brown and Williamson document, is it not, [p. 46-233] Mr. Burnett?

A Yes, it is.

Q And it is headed "FET Price Increase History." What does "FET" mean?

A I believe it stands for Federal Excise Tax.

Q And these price increases along here are what Brown and Williamson called "the history of the federal excise tax price increases," is that right?

A That's correct.

Q Mr. Burnett, what conclusions did you come to with respect to the patterns of list price changes in the cigarette industry?

A List prices for branded cigarettes tend to change by the same amount at about the same time and sell for the same price. And that's a pattern that has existed over many, many years. What this means is the cigarette manufacturers are not using list price differences and rivalry with respect to list price as a form of competition and as a way to try and take business away from one another. They don't compete with respect to list price.

Q Mr. Burnett, do manufacturers and wholesalers anticipate regular list price increases in the cigarette industry?

MR. LONDON: Objection.

THE COURT: Well, you can testify to what they do, what their activities are. Overruled.

[p. 46-234] A There has been testimony here in trial - here in court that --- For example, Liggett and Myers in planning its budget, were forecasting what its revenues and costs will be for the coming year, incorporates in its budget the anticipated price increases. So they, in fact, do anticipate the price increases, and formally put it into their budgeting process.

Further, I believe there's been testimony that wholesalers will often begin purchasing stock up - or quantities of cigarettes prior to the actual price announcements or price increase announcements so that when the price increase comes along, they already have a lot of stock in the warehouse, and what they can then do, or at least attempt to do, is charge the new higher price for all of the cigarettes it has in its warehouse in inventory. That's called taking what's called an inventory gain.

If you're holding that stuff and you only had to pay five dollars for it, and the price increase comes along and it's now worth six dollars, and you can price it at a price reflecting the six dollars, you gain a dollar on everything you have in the warehouse. So the wholesalers do, in fact, according to the testimony, buy in anticipation of the list price increases and in an attempt to take advantage of those inventory gains.

Q Well, Mr. Burnett, does Brown and Williamson [p. 46-235] incorporate anticipated price increases in its budget?

A I believe it does.

Q Now, Mr. Burnett, your analysis is focused on list price competition. Are there other forms of competition in the cigarette market related to price?

A Yes, there are.

Q Can you name some of them?

A Well, there's a long list. There are coupons; there are stickers; there are buy one, get one free ---

MR. LONDON: I'm sorry; I can't hear.

THE COURT: Keep your voice up.

THE WITNESS: Excuse me.

A There are coupons; there are stickers; there are buy one, get one free promotions. There are buy a carton, get a free carton; there are a number of ways that the price to the consumer is reduced by the manufacturer.

Q Does this mean that price competition exists?

A It means that there is rivalry and that the firms do compete with respect to those competitive variables, sure. Stickering is a way to try and take business from your rivals. Buy one, get one free is a way to take business from your rivals. So they are a form of competition and rivalry.

Q Does this mean that the price increases, which you testified are happening twice a year, are used up in these consumer promotions?

[p. 46-236] A Not by any stretch of the imagination. Although there has been an increase in the use of this type of promotional activity over the last four or five years, the increase in that promotional activity has been far outstripped by the list price increases. The prices go up by a lot; the promotional activity, indeed, does go up. But the promotional activity has not gone up by anywhere near the magnitude of the list price increases. Further, those price increases are not warranted by increasing costs, since the manufacturing costs of making cigarettes have remained roughly constant over the last five years.

Q Well, Mr. Burnett, isn't it true that the market shares of the various cigarette manufacturers have changed over time and that those changes indicate the existence of competition?

A Well, the market shares have certainly changed over time. We know, for example, that a key illustration of that is the fact that Liggett and Myers' share in the 1950's was way up here. It was very high (demonstrating), and over a very long period of time, it trended

down. So that by 1979 or 1980 its share was down to less than two and a half percent of all cigarette sales.

Similarly, we know that Philip Morris, from Mr. Sandefur's testimony, that Philip Morris by taking advantage of certain changes in the industry, has introduced some successful new products and built the Marlboro brand over [p. 46-237] time, so that its market share increased quite a lot.

That kind of long gradual change is not necessarily indicative of intense rivalry in competition. If I saw a pattern where shares were changing year to year at the corporate level and going up and down rapidly, that would say that the firms are taking actions to target one another specifically, and to engage in really active rivalry and cause significant instability in their shares.

That's very different from long gradual trends - long gradual changes. And the fact of the matter is, that despite those long and gradual changes, it wasn't until Liggett and Myers was basically pushed to the wall and on the verge of going out of business, that they chose to break with the rules of the game. And the rules of the game said, "no list price competition."

MR. LONDON: I object to this and move to strike it.

THE COURT: You may testify as to what Liggett did without drawing any conclusions from what they did.

THE WITNESS: Yes, sir.

THE COURT: Go ahead, Mr. Hogeland.

BY MR. HOGELAND:

Q Mr. Burnett, did the introduction of Liggett and Myers' generic cigarettes bring about a change in list price patterns?

A The use of --- Excuse me; the introduction of generic

* * *

[p. 47-29] briefly what question you were addressing with your industrial organization analysis and what the first two elements were?

A Very briefly, the industrial organization market analysis is intended to assess the plausibility of predatory behavior in the cigarette industry, whether it makes sense. And the first two features that I discussed yesterday included the number of firms and market concentration in the market as the first issue that I addressed, and the second was the pattern of list price changes that had taken place over a long period of time until Liggett's introduction of generic cigarettes in 1980.

Q And what were your findings with respect to those first two elements ---

A First, the industry ---

Q --- conclusions?

A --- the industry is highly concentrated, and there are a small number of firms. And second, there is a strong pattern of list price leadership, block step pricing with respect to the sale of branded cigarette products over a very long period of time.

Q Now, Mr. Burnett, did your conclusions, a high degree of market concentration in the uniform pattern of list prices and list price changes, indicate to you that cigarette firms are exercising monopoly over market power?

[p. 47-30] A They are consistent with the exercise of market power, and they in a sense peaked my interest. They want me to look further, and I did look further and assess additional evidence and information.

Q What is the next element that you addressed?

A The next thing I looked at was, I basically evaluated whether or not the pattern of changes in prices and costs in the industry were consistent with the patterns of changes and prices and costs that you would find if competition prevailed in an industry. If you find abnormal or unusual movements in prices and costs, there is an assumption -- an understanding that the forces of competition are not working effectively in that market.

Q Again, in a competitive market, Mr. Burnett, what happens to prices if costs rise?

A Well, let's go back to the example I used yesterday about carpet, and let's assume that we have lots of carpet manufacturers in the United States and the carpet manufacturers compete with other manufacturers of floor coverings. If the fabric price -- the stuff that goes into the carpet, if the cost of that rises to the manufacturers for all of the manufacturers, then you would typically expect to see the price of carpet being charged to consumers to rise. However, typically the price would not rise by the full

amount of the cost increase, at least not in the short [p. 47-31] run.

What happens is that as costs rise and manufacturers pass on some of that cost increase to consumers in the form of higher prices to cover the increase in costs, the market price to the consumer will go up. But typically it won't go up by quite as much as the increase in costs, because as the price increases, some consumers begin to cut back on their purchases because they can't quite afford it or they don't want to purchase it in the quantities that they did previously. So a portion of that cost increase will be passed on to consumers, but typically not the full amount of the cost increase in the short run.

Q Well, Mr. Burnett, as an economist, what would you expect to find in a competitive market when costs decline?

A When costs decline, typically the manufacturers in that market, in a competitive market, will compete away those cost decreases. In the short run, let's assume the price of fabric or the price of the rayon that goes into a carpet decreases. Well, in the very short run the firms will have increased profits, but the firms in a competitive market will typically compete away in an attempt to take business from one another he [sic] increased profits and the price will fall. So when the costs fall, prices will also fall.

Q Well, Mr. Burnett, what do you as an economist expect to find the impact on prices in a competitive market when demand [p. 47-32] declines?

A Generally, if the demand for a product declines, the price in the market will also fall. Fewer consumers are then willing to pay the same price for the same quantity as they have been in the past.

A kind of simplistic example of that was the supply and demand for hula-hoops in the early 1960's. For a while hula-hoops were very popular, and the demand boomed, and the price was fairly high. A hula-hoop might cost two or three or four dollars. And then all of a sudden the fad went away and the demand for the product declined, and you could buy a hula-hoop, if memory serves correctly, for 50 or 60 cents.

So when the demand for a product declines, the price in the market will also typically decline in a competitive environment.

Q Mr. Burnett, did you do an economic analysis of whether changes in prices and costs in the cigarette industry were consistent with the existence of effective competition, as you have just described it?

A Yes, I did.

Q Well, what did you look at?

A Well, I looked at a number of facts, but I found a key instance of the inconsistency of changes in costs and changes in prices, which in my view would not have occurred if the cigarette industry was a competitive market, was a [p. 47-33] competitive industry.

Q I show you, Mr. Burnett, what is in evidence as Plaintiff's Exhibit Number 7, and I ask Ms. McCarty to pass copies of that to the jury.

Now I ask you, Mr. Burnett – first of all, can you tell us what Plaintiff's Exhibit 7 is?

A Plaintiff's Exhibit 7, as indicated by the fifth page of the document, was authored by Mr. Blott, the senior vice president of Brown and Williamson, on March the 22nd, 1984. And my understanding is that this memorandum was written as a response or proposed response to a telex that was received by Brown and Williamson in March of 1984 by Mr. Eric Bruell of Brown and Williamson's sister company, the BAT Company in England.

Q Now, Mr. Burnett, what does Plaintiff's Exhibit 7 show regarding changes in prices and changes in costs in the cigarette industry?

A Well, the data I relied upon is, I guess, six pages into the document. It's the first table of numbers with stamp number 087136. And implicitly it reports the prices received by and the costs incurred by Brown and Williamson in the sale of their branded cigarette products in 1982 and 1983. The first two columns of data over here in the left middle portion of the page report actual revenues and actual costs for branded cigarettes for 1982 and 1983.

[p. 47-34] Now the key feature of importance here hinges on basically two or three issues. First, you'll note the third set of numbers down, which report under sales revenue the rate per M. That means the rate per thousand cigarettes, or the rate per each five cartons of cigarettes. That's the average selling price for Brown and Williamson's cigarettes in 1982, was \$21.06.

Moving over one column, you see that the average price for Brown and Williamson branded cigarettes in

1983 was \$27.00. Well, that's almost a \$6.00 increase. Well, that's a lot. But what we also know, and I think I discussed it yesterday, is that on January 1, 1983, the federal excise tax for cigarette products doubled from \$4.00 to \$8.00, so that there was an increase in the costs incurred by Brown and Williamson of \$4.00 between 1982 and 1983.

Now based on the pattern of pricing cost changes I described earlier, with that increase in cost you would certainly expect even if a very competitive market some increase in the market price charged for cigarettes. But again, you wouldn't expect a price increase to be – certainly, you wouldn't expect it to be more than the cost increase.

The other factor that has to be kept in mind is that this is also occurring in the context of a stable to declining total demand for cigarettes. The demand for cigarettes had [p. 47-35] leveled off in part because of concerns over health-related issues. So we've got a stable demand curve and rising costs. And in that environment, you wouldn't expect the price increase to fully reflect the increase in costs.

The surprising feature here is that the prices actually went up by almost \$6.00, confronted with an increase in costs of only \$4.00. That, to me, peaked my interest. It's inconsistent with the existence of effective competition in this market. Prices are going up by more than the increase in costs.

Now just to make sure that something else wasn't going on here that would motivate that \$6.00 per thousand increase, I went a little further down the page. And

although it's kind of an indirect calculation, I can calculate to the penny the factory manufacturing costs of producing each thousand cigarettes in 1982 and 1983 from the data that is included on here, and those calculations show that the manufacturing costs per thousand cigarettes increased by only 11 cents per thousand between those two years.

So combining the \$4.00 increase in federal excise tax per thousand with an 11-cent increase in factory - manufacturing costs, we have an increase in costs of \$4.11. Once again, we've got a price increase of almost \$6.00, and once again, that price increase is inconsistent with the existence of effective competition.

[p. 47-36] And I went one step further, and I asked myself, okay, the increase in the tax doesn't justify the price increase. The increase in the manufacturing cost doesn't justify the price increase. Could it be promotional spendings? Could it be an increase in the use of stickers and coupons? And lo-and-behold, not only is that inconsistent with this price increase, but if you look down on the next line where it says specific marketing rate per M, or again, rate per thousand, you see that between 1982 and 1983 the specific marketing expenses, which include stickers and coupons, actually decreased. It didn't increase.

So my conclusion was that in evaluating the taxes, the manufacturing costs, and the marketing expenses, those costs and changes in those costs do not justify or warrant in the context of a competitive market an increase in market price of almost \$6.00 a thousand. I found that change in market price inconsistent with the

existence of effective competition, and it suggests or implies to me the absence of competition and the existence of market power and the ability of the cigarette manufacturers to raise price above competitive levels.

Q Now, Mr. Burnett, you said that you computed that Brown and Williamson's factory manufacturing costs increased by 11 cents a thousand between '82 and '83. How did you do that computation from the table in Plaintiff's Exhibit 7 on [p. 47-37] Page 087137?

A Well, I can do that in a very straightforward manner from three numbers. If we look at 1982, we see that the sales price per thousand was \$21.06, and we know that the federal excise tax during that period was \$4.00. So --- And I also know as a matter of definition from Brown and Williamson's accounting records that variable margin, which is the second line of data down here which yields \$10.78, is defined formally by Brown and Williamson as sales revenues minus excise tax minus manufacturing costs. And that computation, sales less tax less manufacturing costs, yields variable margin.

Well, I know what the sales price was. I know the tax was \$4.00. And I know the bottom line that after manufacturing costs, they earned \$10.78. I can infer what the manufacturing cost was to the penny, and it came out to \$6.28 per thousand cigarettes, or \$1.26 per carton.

I carried out the same computation for 1983, and I found that --- No, excuse me. The change here was that in 1983 I have a sales price of \$27.00, but now we know that the excise tax is eight bucks, and I know that the variable margin is twelve sixty-one. I can also calculate the manufacturing cost, and it was, in 1983, \$6.39. So the difference

between six twenty-eight and six thirty-nine is the 11-cent increase over that year in factory manufacturing costs.

[p. 47-38] so I can infer as a matter of definition what the actual manufacturing costs were for the firm for those two years.

Q And you find based on your analysis of that chart that prices were going up more than costs; is that correct?

A Yes, sir.

Q Now is there a later Brown and Williamson document that further illustrates this point?

A Yes, there is. In particular, the document that Mr. Sandefur testified that he took to London in mid-May of 1984.

Q Is that Plaintiff's Exhibit 12, sir?

A Excuse me. Yes, it is.

MR. HOGELAND: And Ms. McCarty is now handing that out to the jury.

BY MR. HOGELAND:

Q What on Plaintiff's Exhibit 12, Mr. Burnett, further confirms your conclusion that prices were rising ---

A Well, if we just look at the first paragraph on the document on the first page under background, and you refer down to the second to the last sentence in that paragraph that begins "In 1982." It reads, "In 1982, the industry became much more aggressive on the pricing front. Fueled by a 100 percent increase in the federal

excise tax. Brown and Williamson's variable margin increased from \$10.78 per M" - or per thousand - "in 1982 to twelve dollars and sixty" - excuse me - "\$12.61 per M in 1983."

[p. 47-39] Now those numbers tie exactly to the document we just reviewed. The variable margin on Plaintiff's Exhibit 7 that I just discussed are exactly \$10.78 in '82 and \$12.61 in 1983. Now what struck me as an economist in contrasting the data from PX-7 with the statement in PX-12, Brown and Williamson's final proposal for entering the generic category, is that firms in competitive industries ---

MR. LONDON: Your Honor, I move to strike that: This is not a final proposal, and the witness is now going beyond any sort of expert testimony and is now just making things up. As a matter of fact, he's testifying contrary to the testimony of Mr. Sandefur, and he may not sit there as a paid witness and decide which witness he would like to credit.

THE COURT: Well, he can testify to documents on what he is relying. If this is a document on which he is relying, he may say so. Now his characterization of the document and his understanding may or may not be correct as to whether this was, for example, a final document. But the jury will have to use their recollection of the evidence as to what Exhibit 12 was testified to be by witnesses who testified about it.

MR. HOGELAND: Well, Your Honor, just so the record is clear, Mr. Sandefur himself testified here September 7, 1989, referring to the financial schedules in

Plaintiff's [p. 47-40] Exhibit 12, quote, "This is the company's official position." So I don't think it's correct to say that Mr. Burnett has mischaracterized this document.

THE COURT: Well, if he's relying on that testimony, he may testify. And if the jury thinks that that is not something that he should rely on or that is not a correct characterization of the testimony, they may take that into account.

Yes?

MR. LONDON: What I moved to strike was the phrase "the final proposal," because there is no doubt that this was not the final proposal, and the evidence so contradicts it.

THE COURT: I understand that. All right. That is what I initially addressed. We are now talking about the table.

MR. BARKER: Your Honor, this is in the affidavit in the record in this case.

THE COURT: Well, there seems to be a dispute between the two of you as to whether it was a final proposal.

MR. LONDON: I don't think that there's any dispute about that, Your Honor. I don't want to argue in front of the jury.

THE COURT: I know. Let me see you at the bench very quickly on this one.

(Bench conference on the record.)

[p. 47-41] MR. BARKER: Your Honor ---

THE COURT: Mr. Hogeland just read -- said that Mr. Sandefur testified that this was a final -- the company position, or something.

MR. HOGELAND: Official position of the company, Your Honor.

THE COURT: And your concern ---

MR. HOGELAND: It was the final proposal as characterized by Brown and Williamson in affidavits filed in this case more than once.

THE COURT: You're talking about the whole document or ---

MR. HOGELAND: Yes, sir.

MR. BARKER: From Mr. Butler, Mr. Bacon, and Dr. Elzinga.

MR. LONDON: Really, we were getting into a rhetorical bicker. If he wants to use the table, I didn't object until the witness decided to become the advocate and called it a final proposal. There was testimony by Sandefur that this was before BATUS said no, you've got to have a dollar, you've got to have Charlie's dollar. This was not, said Sandefur, what we went to market with. This was not the final. This was rejected. This was a paper. There were papers in February, there were papers in March, there were papers in May, and this was not the final.

[p. 47-42] Now we can argue that in summation, and I'm prepared to do that. But what I'm trying to avoid now, I don't want to get up and object every time the witness speaks.

THE COURT: I understand.

MR. LONDON: But I don't want the witness to get up there and make credibility assessments and make summations. He was doing just fine, talking about the table, but he couldn't resist. He's been too well trained. So he had to say "the final proposal." That's what I want to avoid.

THE COURT: Yes, I understand that, but let's don't get into that.

MR. HOGELAND: Well, Your Honor, let me just respond to that briefly. There are many affidavits that Mr. London and Brown and Williamson filed in this case, Mr. Butler, Mr. Bacon, which called this, in those words, "Brown and Williamson's final proposal." This economist has studied these documents, and if he comes out with that kind of characterization, it isn't because he is well trained. It's because he's done his homework and read these documents.

THE COURT: All right, sir. I cannot resolve that issue, because I don't have all of the testimony here before me. You're [sic] read part of it, which --- Let's go ahead. He's already testified. I will not strike it.

(End of bench conference.)

THE COURT: All right. Go ahead with the next ---
[p. 47-43] BY MR. HOGELAND:

Q Now, Mr. Burnett, you referred to the last two sentences in the first paragraph on Plaintiff's Exhibit 12. Is there more in there that illustrates your point that prices - changes in prices and changes in costs were not

consistent with what you would expect to find in a competitive situation?

A Well, the point I was going to make was that firms in an effectively competitive market do not succeed in becoming aggressive on price.

If we go back again to the carpet example and the floor covering example, to the extent that a firm attempts to get aggressive with respect to price and raise it to levels that do not reflect increases in costs, they lose business to their competitors. They do not succeed in increasing margins to the extent that they were increased as reflected by this data.

And adopting a pricing policy which is aggressive and succeeds in raising margins and profits is inconsistent, again, with the existence of effective competition.

Q You were using the phrase "aggressive in price" to mean increase in price?

A In this context, there is no ambiguity about that. The prices between 1982 and 1983 went up by almost \$6.00, and the margins earned by Brown and Williamson, even after taking [p. 47-44] into account changes in manufacturing costs and changes in marketing expenses, increased by about \$2.20. So in this case there is no ambiguity about what "aggressive" means. It means price increases.

Q Now, Mr. Burnett, in addition to these two examples centering around the time of the federal excise tax increase, have you looked at anything else regarding changes in prices and changes in cost?

A Yes, I have. It is not quite as direct. It's more indirect. But I have reviewed all of the Brown and Williamson financial data that may bear on this issue, some of it stretching back to 1974 and extending through 1988, and other data beginning in 1984 through 1988, and yet another set of data beginning in 1983 and stretching through 1988.

And what I find over the period of the 1980's and at least from 1984 through 1988 is that this pattern of increases in the margins earned on Brown and Williamson's cigarettes over that period continued to increase in a manner unwarranted by increases in manufacturing costs; costs, taxes, or promotional expenditures.

For example, we had for 1982 and 1983 an increase in what's called brand contribution from seven eighty-two to \$10.00, as reflected on PX-7. If you look at that same measure of margin for Brown and Williamson's cigarettes through 1988 ---

[p. 47-45] Let me just back up. Brand contribution is formally defined as revenue minus tax minus merit manufacturing costs minus such things as stickering and promotions and rebates. You find that from 1984 through 1988 the brand contribution comparable to these numbers down here increased from 1984 of \$12.21 to 1988 of \$17.38. They continued to increase in a manner unwarranted by increases in taxes, manufacturing costs, or promotional expenses.

So I find that the specific data referred to in PX-7 carries through 1988 for Brown and Williamson's products in general.

Q Now, Mr. Burnett, taking into account the three elements of your industrial organization market analysis that you have discussed, that is, a high level of concentration, the patterns of list price changes and list pricing uniformity, and the relationship between price changes and cost changes, did you conclude that effective competition does not prevail in the cigarette industry?

A I'm becoming more and more persuaded as we add more and more information to that puzzle, and based on these three pieces of information I'm becoming pretty confident that effective competition does not prevail, and firms in this industry both possess market power and exercise that market power.

Q Does that indicate that predation could occur in the [p. 47-46] cigarette industry?

A Once again, if the firms in the industry exercise market power so that prices are held above competitive levels, one of the larger firms in the industry may well have the incentive to engage in predatory behavior in an effort to protect and defend the high prices and profits that are earned on the branded cigarettes.

Q Now, Mr. Burnett, you mentioned additional elements as part of your industrial organization market analysis. Now you testified that you analyzed the profitability of cigarette manufacturers. What do you mean by analyzing the profitability of cigarette manufacturers?

A Well, when firms successfully exercise market power and raise prices above competitive levels, and when they are able to keep those prices above competitive levels for a sustained period of time, a manifestation

- an outcome of those high prices is typically the existence of high profits. The firms earn more on their investment if they are able to maintain prices above competitive levels versus the same period of time.

So one test of whether or not prices are above competitive levels hinges on or is measured by whether or not the profitability of the firms which are believed to exercise market power and raise market price are above the profits of firms that compete within competitive markets. If you've got [p. 47-47] market power, if you've got monopoly power, the profitability of participating in that market will exceed the profitability that will exist in competitive markets.

Q Now, Mr. Burnett, I show you what has been marked as Plaintiff's Exhibit 4067-R, and I ask you, sir, if you can tell us where you got the information that appears on that exhibit.

A This is data on the profitability of firms that are classified as manufacturing food and kindred products in one industry classification, and as firms that are classified as manufacturing tobacco products or who are in the tobacco industry in another industry classification.

Q Well, where did you get the information that's on that exhibit, sir?

A The data is derived from a federal government report currently published by the U. S. Department of Commerce, called a quarterly financial report.

MR. HOGELAND: Your Honor, I move the introduction into evidence of Plaintiff's 4067-R.

MR. LONDON: No objection.

THE COURT: Admitted.

MR. HOGELAND: And I ask Ms. McCarty to pass copies out to the jury.

(The document above
(referred to was received
(into evidence as:

(PLAINTIFF'S EXHIBIT
(NO. 4067-R

[p. 47-48] BY MR. HOGELAND:

Q Now, Mr. Burnett, I show you documents identified as Plaintiff's Exhibit 3933-F, G, H, and I, and I ask you what they are.

A These are copies or pages from copies of the quarterly financial reports.

Q And all of them are published by the United States Department of Commerce; is that right?

A They are currently published by the U. S. Department of Commerce. Until the earlier 1980's they had been published by the Federal Trade Commission, and responsibility for that document changed somewhere around 1982 or '83.

Q Now returning to Plaintiff's 4067-R, can you describe for us what you have displayed on that exhibit?

A Yes, sir. Let me take it in a couple of steps. There are two pages to the document. The difference between the first page and the second page is that the first page measures a rate of profit before corporations pay taxes.

That's why on this heading down here, the third underlined portion, it says pretax return on stockholders' equity. That means it's the profits the firm earns on the investments that individual investors have made in the business in the form of holding stock or in the retained earnings - or in the revenues the firm retains within the corporation at the end of the year and does not pay out in the form of dividends to [p. 47-49] its stockholders.

Q Mr. Burnett, can you tell us what you mean by rate of return or return on equity?

A Yes. The stockholders' equity is the amount of money invested by stockholders in the business. That's to be distinct from bonds that the firms may issue that have a fixed commitment or an interest rate that they have to pay. The stockholders' equity is like holding stock in the company, and it reflects the investment the investors have in the corporation. And it is a rate, because typically the way you measure profitability is it's a measure of income as a function of or divided by the total amount invested in the business.

If all you knew was, for example, that a firm was earning \$150.00, you wouldn't know whether that was a lot or a little without comparing it to the amount that was necessary to be invested in order to get the \$150.00 back. So what the rate of return does, is it takes the income measure and divides it by the investment to get a rate.

Q Well, does it follow, Mr. Burnett, that the higher the rate of return, the more profitable the business is?

A That's right. Let's assume that a firm invests, say, \$1,000.00, or a firm has a total investment of \$1,000.00,

and it earns \$150.00 in income. That would be a rate of return of 15 percent, one hundred and fifty over a thousand.

[p. 47-50] On the other hand, if the firm invested \$2,000.00 and it only got a return of a hundred and fifty, they'd be earning seven and a half percent, and that would be a less profitable investment.

So what this does is it takes the measure of income and divides by the measure of investment. The higher the number for a given level of investment, the higher the rate of return, the more profitable the activity is. That's what these measure. It is a measure of income divided by the investment by shareholders in the corporation. The first page is a before-tax return, it means before the corporation pays its taxes; for example, the corporate income taxes that it owes to the U. S. Federal Government. And the second page is the after-tax return, or it's the measure of income after the corporation has paid its tax obligations.

I selected for comparison industries defined by the quarterly financial reports as being food and kindred product industries, or food and kindred product-related companies, and the tobacco industry category as defined by the quarterly financial report, to compare the relative profitability of firms engaged in tobacco activities and firms engaged in non-tobacco but food and kindred product-type activities.

And the conclusion I reached based on this analysis doesn't much matter whether you look at the first page or the second page. The answer is the same. If we focus just on [p. 47-51] the first page for purposes of illustration

now, you see that firms classified as manufacturing tobacco products had a pretax return on stockholders' equity of about 32 percent for the period extending from 1979 through 1985. Over the same time period the firms engaged in food and kindred product-related activities had a pretax return of 21.5 percent.

What that means is that firms that engage primarily in tobacco manufacture earned about 50 percent more than firms engaged in food and related product activities. If memory serves, I did the calculation, and it was approximately 47 percent more. But they earned more, it's higher. And you get the same answer looking at the second page, and again, the tobacco industry earns 20 percent after-tax return on stockholders' equity, while companies classified as food and kindred product companies earned only 13.6 percent, and again, that's a little less than a 50 percent difference.

What this showed me was that in very gross terms, firms engaged in the manufacture of tobacco products earn higher rates of return, earned higher profits on their investment than do firms engaged in food and kindred product activities.

Q Well, Mr. Burnett, does Plaintiff's Exhibit 4067-R and the data in the QFR's for the tobacco industry reflect the turn on stockholders' equity of only the cigarette activities of the tobacco companies?

[p. 47-52] A No, sir, it doesn't.

Q Well, do the tobacco companies or many of them engage in diversified activities other than cigarettes?

A Yes, and that's the point. When the data is submitted to the Department of Commerce, the Department of Commerce will take a company and put it in one of these industry groups, depending on its principal or primary line of business. So if a company is primarily a tobacco manufacturer, but also has related products, all of the income and assets that are derived from or centered in that company are put in this tobacco category, even though some of them are non-tobacco industries. So this is an average for a corporation. It includes both tobacco-related activities and some non-tobacco-related activities.

Q Well, did you do any analysis to determine whether or not the profitability figures from the QFR overstate the cigarette earnings of each company?

A Yes, I did.

Q What did you do?

A Well, I went to each of the six tobacco manufacturers annual reports, which are reports that each company must file with the Securities and Exchange Commission every year, and which become available to the public and to potential stockholders in the corporations, in an attempt to determine what the relative profitability of the cigarette activities [p. 47-53] of the six major manufacturers - how the profitability of the cigarette activities of the major manufacturers compared to the - compared with the profitability of the cigarette manufacturers' other lines of business or other types of business that they engaged in, to make sure as a first step that this did not overstate the profitability of the cigarette manufacturers.

And quite to the contrary, the data presented here systematically understates the profitability of the cigarette manufacturer. And if what we had was data limited only to the cigarette activities of the tobacco companies, the difference between these two numbers would be even larger. In contrast to the 21.5 percent, if we has [sic] just cigarette activities, this number for cigarettes alone would be more than 32.2 percent.

Q Well, did you do anything - did you limit your analysis to the worldwide cigarette activity reported by the companies, or did you make an effort where possible to limit it to domestic United States cigarette activity?

A To the extent I could, I did both. I looked at the profitability of each line of business for each year from 1979 forward for each of the six cigarette manufacturers, and I looked at the profitability of individual lines of business within those corporations, and found that overall cigarette activities were systematically and dramatically more [47-54] profitable than almost anything else they did in almost every year but not quite.

And then I also looked at the profitability of each company's domestic activities as opposed to its international activities to make sure that somehow the high profits as reflected in their tobacco operations weren't a function of or dependent on their international cigarette sales, their international tobacco activities. And once again, I found that the domestic activities of each of these firms tended to be more profitable than the international or the export activities of each of the firms.

Q Did you consult any other material in your analysis of the profitability and rates of return in the cigarette industry?

A Yes, I did.

Q Would you tell me what some of it was?

A Yes. In a fairly routine manner, several of the large stock brokerage houses like Merrill Lynch and Paine Webber publish reports critiquing or evaluating the lines of business and business activities of major corporations. And one of the exercises they go through as a routine matter is very similar to what I did, looking at the individual annual reports of each company, and they will often break down the returns earned by each company's individual line of business.

Q And, Mr. Burnett, I show you Plaintiff's Exhibit 233, and [p. 47-55] I ask you to tell me what that is.

A This is a copy of a brokerage house report on the R. J. Reynolds industries company, dated April 1983.

MR. HOGELAND: Your Honor, I move the introduction into evidence of Plaintiff's Exhibit 233.

MR. LONDON: May we approach, Your Honor? Again, we were given a list of all of the documents that were offered, and this is not on the list, and I don't know why they do this.

THE COURT: All right. Let's see you at the bench.

(Bench conference on the record.)

MR. HOGELAND: Your Honor, my understanding is that this was on the list sent to them.

THE COURT: Well, what is the Reynolds – what is the Reynolds document going to have to do with it anyway? Plaintiff's exhibits that may be put in evidence --- If it's not in numerical order, it's not on the list. I said if it is in numerical order, it's not on the list.

MR. RINGELBURG: I believe it's on the list, but I'm just trying to find my copy.

MR. LONDON: You can look at mine.

MR. RINGELBURG: You also wrote a letter on the 25th and the 26th.

MR. LEFELL: It doesn't include Number 223.

MR. LONDON: We have a stack of a zillion documents, [p. 47-56] but we never saw this before.

MR. HOGELAND: Well, if it's not on this one, I'm not going to move it into evidence.

MR. RINGELBURG: I don't have my copy of the list with me.

THE COURT: What are we doing? Are you going to say that it was ---

MR. HOGELAND: I'm not going to offer it if I didn't give them notice of it. I mean, the agreement prevents me from it. My understanding is that we did.

MR. LONDON: Are we going to wait while he looks, or ---

THE COURT: Yes, why don't we wait a minute while he looks? Is it at your table?

MR. RINGELBURG: I think it is.

MR. HOGELAND: Well, do you want to take a break now?

THE COURT: Why not?

MR. HOGELAND: Okay.

(End of bench conference.)

THE COURT: Okay. Ladies and gentlemen of the jury, we've got to check one document. And the rest of us have been here since 9:30, so it's probably a pretty good time for a break. If you want to go downstairs, you may do so. And please just leave your documents there at the jury box.

[p. 47-57] All right. Mr. Belvin?

(Jury out at 10:55 A.M.)

THE COURT: All right. Let's take about 15 minutes.

(Short break from 11:05 to 11:20 a.m.)

MR. LONDON: If Your Honor please ---

THE COURT: Yes?

MR. LONDON: Inquiry in the interim has revealed that following the long list of exhibits that they notified us, there is a letter that's dated September 26 that they represent that they telexed us with four omitted exhibits.

While we don't say that we didn't get it, it's just that – it may well be there, and we may well have seen it. It's certainly something that we didn't focus on.

But that's the letter that contains four exhibits. I'm not claiming that we didn't receive the facts. I did review in advance of the testimony scores of exhibits that they said they were going to introduce, and we told them which ones we were going to object to and which ones we weren't.

I've never seen this one before. It's a 38 or 9 or 7 page single-spaced document that is apparently a report from Merrill Lynch on RJR. And it has extremely limited relevance here. It's something that the witness said that he looked at.

[p. 47-58] My suggestion would be to hold it, let us look at it overnight and read it. If we want to go forward with it now, I certainly would object to it on the ground that if it has any probative value or has something on which the expert relied and therefore admissible, but not for the truth of its contents.

The possible prejudicial and accumulative weight of all this stuff with respect to the limited relevance is ---

THE COURT: What is the relevance of this Reynolds document? I mean analysis.

MR. RINGELBERG: Mr. Burnett, in addition to doing his own analysis on profitability, looked at analysts who evaluated tobacco company profitability, and this confirms Mr. Burnett's analysis.

Your Honor, I just wanted to bring your attention to what we did disclose in the November 26 letter which we've used, Exhibit 233, which is also in the pre-trial order, and on October 3rd I sent a letter to Mr. Lefell and to Mr. Robinson, Michael Robinson, which I stated to

confirm my telephone conversation about what their exhibits -- what there are objections to our proposed exhibits were.

I said, "It's my understanding B & W's objections to the exhibit listed in my letters of September 24, 25, and 26 and October 2nd are to only the ones they had informed me about."

[p. 47-59] So they not only got the letter of the 26th; they got my confirming letter which said the exhibits listed in the letter dated October 26, so ---

MR. HOGELAND: And, Your Honor, this document was in the pre-trial order, so their statement that they're never seen it before comes a little late when we have this agreement, when we give advance notice of exhibits we're going to use. We give this to them on September 26. We get a response as to all of their objections, and then they want to hold up in the middle of the examination while they want to read it.

I mean, you know, we've complied not only with the pre-trial order but with all of the agreements that we have here.

And then we have a statement made in front of the jury that we never showed it to them, which is wrong.

And then we have an effort to hold up the examination.

MR. LONDON: Your Honor, perhaps I didn't speak clearly. I thought I said when I first rose that we are not denying receiving the letter. What I said was that they sent up a letter saying they had left off four exhibits from the list that they sent us that I --- I'm not denying we

received it. I don't have a copy of it in my file, but I'm not denying we received it.

[p. 47-60] If you say you sent it, I'm confident you sent it. I don't ask for an admission of service. I don't ask for the certified mail receipt. I say that, in fact, I never focused on it.

Now I've heard Mr. Ringelberg's explanation of why the document is admissible, and I think we ought to go directly to that.

I heard Mr. Ringelberg say that the document is admissible because this is an analysis performed by Merrill Lynch analysts that confirms the witness's analysis. That Merrill Lynch --- So it's offered to prove the truth of its contents. The Merrill Lynch analyst is not here on the stand, is not here to be cross examined. I don't know what he relied on, and I don't know how we could have an unsworn statement by a Merrill Lynch analyst to prove the truth of this analysis.

THE COURT: Well, what he's going to say about this is this is the type of information I relied on? Is that all he's going to say about it?

MR. HOGELAND: Yes, Your Honor. That's exactly the information he relied on, and it is normal for an economist to use this kind of information. He's already testified to that.

THE COURT: Yes. I understand that This deals with just Merrill Lynch. I don't think there's any real [p. 47-61] dispute, as I understand it, as to the tobacco business's profitability from one of the parties; maybe there is. But he can testify, yes, Exhibit 233 is the type of

information stock brokers and analysts rely on. What else is he going to do with it?

MR. HOGELAND: Well, that's what he's going to do with it, Your Honor. And I want to be able to put it in evidence.

THE COURT: I mean, is he going to --- Do you want to talk about the contents of it?

MR. HOGELAND: Yes, Your Honor. Yes, Your Honor.

THE COURT: Well, he can talk about that, and I'll instruct the jury that it's not admitted for the truth of it if there's a problem in that regard.

All right. Let's bring the jury in.

MR. FOSTER: Your Honor, could I bring up one more thing?

This argument, I think, is illustrative of a larger problem that we have, and that is the problem of our speaking objections.

We had the dispute as to whether or not the document that Mr. Burnett was testifying about had been described by Brown and Williamson as their final proposal.

And what I've just handed to Mr. Gordon are the affidavits of no less than four Brown and Williamson [p. 47-62] employees or experts in which the very document that Mr. London said, in front of the jury, there was absolutely no evidence to describe it as the final proposal.

Mr. Butler describes this document as "the final generic proposal." Mr. Bacon describes this document as "I attach a copy of this final proposal as exhibit 1. Brown and Williamson prepared a final proposal recommending," blah, blah, blah, blah, blah.

Professor Weil says, "It's May 1984 final proposal for introducing generics attached is exhibit 1 to this affidavit."

Professor Elzinga described it as "the plan it ultimately adopted."

THE COURT: Well, I do remember now Mr. Sandefur saying, "Yes. This is it."

MR. FOSTER: And he squealed with delight on the witness stand when we - as he said - "we've finally gotten to it."

THE COURT: I remember.

MR. LONDON: I move to strike that one too, Judge.

THE COURT: I remember his testimony in that regard. He was animated.

MR. FOSTER: Indeed. But, you know, I certainly don't --- I'm not trying to say that Mr. London intentionally said it at all.

[p. 47-63] It's just that if we can confine ourselves, if we have a problem.

THE COURT: Well, it's about a draw between the parties on those type of things, and sometimes I will ask for the grounds for it if it can be simply stated and

avoid a bench conference. But otherwise we will try to confine ourselves to making objections.

Now hopefully we will be able to get through Mr. Burnett's testimony the rest of this morning without any major problems.

I'm beginning and have looked at some of the cases that both parties have cited on the question of intent, and we'll try to look at some more of those again during lunch.

All right, Marshal.

(Jury in at 11:25 a.m.)

THE COURT: All right, Mr. Burnett. If you'll come back, please.

All right. Now when we took the break, Mr. Burnett was shown Plaintiff's Exhibit 233, and I don't believe he's said what it was yet. He may have, but I don't know that he did.

MR. HOGELAND: I believe I moved its admission into evidence, Your Honor.

THE COURT: Well, let's see what it is first. If my understanding is correct of what it is and what he did [p. 47-64] with it ---

WILLIAM B. BURNETT, PLAINTIFF'S WITNESS,
PREVIOUSLY SWORN

DIRECT EXAMINATION (CONTINUING)

BY MR. HOGELAND:

Q Mr. Burnett, can you tell us what Exhibit 233 is?

A Exhibit 233 is a stock brokerage analysis of the R.J. Reynolds Industry Incorporated Company dated April 1983 prepared by Merrill Lynch.

Q Is this the kind of security analysis that you as an economist regularly consult in doing industrial organization market analysis?

A Yes. This kind of report provides general background information on major manufacturers in general throughout the U.S. economy.

THE COURT: Did you use this as some of the material you relied on in testifying?

THE WITNESS: Yes, sir. I find that this confirms the opinions I reached based on other information.

THE COURT: All right. The Court will admit 233 as the type of material relied on by the witness in reaching his conclusions, not necessarily for the truth or falsity of the statements made by Merrill Lynch therein but as a document that Mr. Burnett relies on in giving his testimony.

[p. 47-65]

(The analysis above
(referred to was received
(into evidence as:

(PLAINTIFF'S EXHIBIT
(NO. 233.

MR. HOGELAND: Your Honor, I will ask Ms. McCarty to pass out copies of Exhibit 233 to the jury.

BY MR. HOGELAND:

Q Now, Mr. Burnett, can you tell us what in Plaintiff's Exhibit 233 you referred to in conducting your industrial organization market analysis?

A Yes, sir. There were two general pieces of information that I found potentially important in my analysis.

If we could turn to page ---

MR. LONDON: Could the witness testify when he looked at this?

THE COURT: Yes, sir. If you would, please. You looked at this in preparing for your testimony and reaching conclusions or when?

THE WITNESS: I have seen this report in the past. I don't remember with precision when I first saw it. I reviewed it within the last several weeks in preparing for my testimony certainly, but I recall seeing it in the past. And over the years in working on this case, I've reviewed a number of similar types of analysis on different companies in the industry of a similar nature to this.

[p. 47-66] THE COURT: All right. Go ahead.

A The first piece of information that I found ---

MR. LONDON: May we approach, Your Honor?

THE COURT: Yes.

(Bench conference on the record.)

MR. LONDON: In light of the witness's inability to say that he read this document before he reached his conclusions, I move to strike the exhibit.

THE COURT: Well, he said he's seen it before in preparing for his testimony.

MR. LONDON: He reached his conclusions in 1986.

MR. HOGELAND: He reached his conclusions in 1986. He listed a lot of stuff. He read a lot of stuff then and has continued to do his analysis as he has said.

THE COURT: I will admit it.

(End of bench conference.)

BY MR. HOGELAND:

Q Now as you were answering before the interruption, Mr. Burnett, what is it in Plaintiff's Exhibit 233 that you referred to in conducting your industrial organization market analysis?

A Well, the first piece of information is on the third page of the document which has the page number on it of page 11. And midway down the page there is a table titled "Return on Assets by Line of Business, 1977 through '82." [p. 47-67] And Merrill Lynch carried out an exercise similar to that that I did for a different period measuring the return on assets by operating divisions of R.J. Reynolds for that period of time.

And in scanning, for example, down the column headed "1977" one observes very quickly that the domestic tobacco operations of R.J. Reynolds were, as measured by this return on assets, far more profitable than anything else R.J. Reynolds did in 1977. And that same pattern exists throughout the period.

The domestic tobacco operations of R.J. Reynolds are more profitable than anything else they did, including their international tobacco operations which are reported on the second line of that table.

And looking to the top of the page in the text, Merrill Lynch wrote, "The domestic tobacco business affords, by far, the highest return on investment of any Reynolds activities." And it refers to the table below. "But since volume growth is so low, it does not offer Reynolds enough opportunity to reinvest a significant enough portion of its cash flow in this area."

That reflects the fact that in unit terms cigarette volume wasn't growing, and R.J. Reynolds doesn't have the opportunity to reinvest all of the profits concerning cigarettes back into the cigarette industry.

[p. 47-68] And at this time in R.J. Reynolds' history it was, in fact, diversifying away from tobacco in an effort to use the cash that was being thrown off by cigarettes.

The second point I draw your attention to is on page 19. It's headed "Page 19." And at the beginning of the first full paragraph on that page Merrill Lynch wrote, "The cigarette companies enjoy virtually all of the advantages other than rapid unit growth that any other industry does. They have usually played the part of a well managed oligopoly pricing up aggressively. They have rarely indulged in excessive price promotions for any sustained period."

And then it goes on: "And they face virtually no threat of entry by a new competitor as is often the case in

many consumer product lines for this is a highly technical business. It also requires heavy marketing outlays to gain share."

And then it refers to Brown and Williamson's introduction of the Barclay brand on which they invested a great deal in advertising and promotional activities in the first few years of its introduction.

I found the page 11 data consistent with my analysis, that the returns to tobacco and cigarette activities were highly profitable relative to other lines of business, and the statement about this being a well managed oligopoly and pricing up aggressively are also consistent with the [p. 47-69] observations I made independently with respect to pricing practices and activities in the cigarette industry.

THE COURT: Keep your voice up, please, sir. I'm having trouble hearing you, and I'm sure they are when your back is turned that way.

THE WITNESS: Yes, sir.

A That completes my assessment of that document.

BY MR. HOGELAND:

Q Mr. Burnett, did you look at any Brown and Williamson documents regarding profitability in the cigarette industry?

A Yes. There are several that bear on the issue of profitability of tobacco and cigarettes relative to other lines of business.

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Supreme Court, U.S.

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October Term, 1992

— ♦ —
LIGGETT GROUP INC.,
now named Brooke Group Ltd.,

Petitioner,

vs.

BROWN & WILLIAMSON
TOBACCO CORPORATION,

Respondent.

— ♦ —
On Writ Of Certiorari To The
United States Court Of Appeals
For The Fourth Circuit

— ♦ —
JOINT APPENDIX
VOLUME III, PAGES 548-851

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KEY

In this Joint Appendix, brackets indicate text added by counsel to inform the Court of appropriate notations or other information not appearing on the face of the document itself. Where the date of a document has been derived by reference to its accompanying testimony, the citation (Tr. __:__) to such testimony has been included with the document's date.

[Excerpt of Trial Testimony of: W. Burnett - con't]

Q I show you Plaintiff's Exhibit 236 which is in evidence. And I ask Mr. Barker and Ms. McCarty if they will pass copies out to the jury.

Now, Mr. Burnett, what is Plaintiff's Exhibit 236?

A This is a document titled "The Domestic Competitive Analysis" prepared by the Brown and Williamson Corporation. And during this period, in the area of 1982 through '84, it was prepared on a regular basis or updated with some frequency by Brown and Williamson. And I believe Ms. Olges testified to how some of these documents have been compiled.

For purposes of assessing profitability, if we could turn to pages 82 through approximately 86.

[p. 47-70] Q Are you referring to Bates Page beginning 264415?

A That's correct. And through Bates Number 264419. We see on document page 82 or Bates Number 415 that Brown and Williamson is calculating the corporate financial ratios for each of five - not six but in this case five - of the cigarette manufacturers.

And then on the next page they evaluate the performance of the tobacco activities of those firms, and on subsequent pages they continue their evaluation of just the tobacco activities of those companies.

And while the numbers require some manipulation and interpretation, Brown and Williamson is effectively carrying out the same type of analysis that I did in comparing the performance of tobacco activities of these corporations with the returns earned by the corporations as a whole.

So once again, Brown and Williamson was carrying out the same type of analysis that I did based on the same type of accounting data that I did. It was drawn from publicly available information for each of these companies.

BY MR. HOGELAND:

Q Mr. Burnett, I show you Plaintiff's Exhibit 230A which is in evidence. And I will ask Ms. McCarty to hand copies of that to the jury.

Could you tell me what Plaintiff's Exhibit 230A is, Mr. Burnett?

[p. 47-71] A Plaintiff's Exhibit 230A is a memoranda prepared by Ms. Trina Ogles, a Brown and Williamson employee, compiling and reporting data that had originally been published by the Federal Trade Commission in what was, at the time, called the line of business report.

For a period of time in the mid-1970's, from about 1973 through '77, the Federal Trade Commission compiled a special report of financial data by individual line of business within major diversified corporations throughout the U.S. economy, precisely to get around the problem I had in looking at corporate financial data.

The corporate financial data blends the profits and the assets and the income derived from a number of different lines of business. The FTC at the time in part was attempting to have the corporations break out those assets and that income. And that's what the ---

Q Mr. Burnett, let me show you Plaintiff's Exhibit 3932C and ask you if that is the line of business report about which this exhibit speaks?

A Yes. It is. This was the report published by the Federal Trade Commission for the year 1976 and which is the subject of Ms. Olges' memo in 1983.

Q Can you tell me when the line of business report for 1976 was published, sir?

A This one finally appeared in May of 1982. There was, at [p. 47-72] the time, quite a substantial time lag between whom [sic] the data was compiled and when it was subsequently -- or when it was collected and when it was subsequently put together and published. It was a lot of work.

Q Now going back to Plaintiff's Exhibit 230A, can you explain how that relates to your study of profitability in the cigarette industry?

A Quite honestly, Ms. Olges did the same thing I did when I first started looking at the cigarette industry. Having been at the Commission at the time that the line of business data was being collected, I was aware that this data source existed.

And I went to the line of business reports for each year from 1973 through 1977 to see what information I could garner on the cigarette industry from the L.B. reports.

Ms. Olges is reporting the line of business reports for the cigarette industry on the second page of this memorandum and comparing it to the average for the entire sample of industries that the Federal Trade Commission collected data for.

Now in the 1976 survey that Ms. Olges is summarizing, there were -- if memory serves -- approximately 250

different industry categories that they compiled information for. This data, over until the last column over here on the far side which says "All Manufacturing Average." The rest of the data [p. 47-73] pertains only to the cigarette industry.

And the first line is of particular interest to me. It is the measure of operating income to assets. That is a different measure of the profitability or the profit of cigarette activities.

And you'll see that the cigarette industry earned 24.3 percent as measured by operating income to assets.

The second column is misnumbered or mislabeled. This is really cigarette industry, and it should read "Rank." It is the rank of the cigarette industry within the 250 that were compiled by the Federal Trade Commission, and the cigarette industry ranked Number 12 in terms of profit as measured by this ratio of the 250.

And over in the far right column it shows that the average for all manufacturing as compiled by the Federal Trade Commission's line of business was 12.3 percent or roughly half of the cigarette industry's average.

In the alternative, the cigarette industry was earning roughly double what the all manufacturing average was. Once again, this is similar - a similar type analysis and consistent with the earlier analysis I did myself and that which was reported by Merrill Lynch and that with which was reported in the Domestic Competitive Analysis.

Q Mr. Burnett, do economists in conducting an industrial organization market analysis normally take

into account [p. 47-74] articles that appear in the business press?

A It is information and provides general background that is recognized and use.

Q Did you do that in conducting your study of profitability in the cigarette industry?

A Yes. I used the trade press or magazines and newspapers for both information on profitability and general industry activity.

Q And have you selected any articles in the *Trade Press* as illustrating your analysis?

A Yes. I have.

Q I show you Plaintiff's Exhibit 1380 and Plaintiff's Exhibit 7187, and I ask you if you can describe what they are and the extent to which you consulted that type of information.

A Plaintiff's Exhibit 7187 is an article taken from the Sunday *New York Times* business section on June 12, 1988, titled "Cigarettes: Still Big Business." And it is - it provides general industry background and information on the cigarette industry.

Plaintiff's Exhibit 1380 is an article that appeared in *Business Week* magazine on December 22, 1986, and is titled "Tobacco Company Profits Just Won't Quit."

Those are the two articles that I selected for illustrative purposes.

[p. 47-75] MR. HOGELAND: Your Honor, I move into evidence Plaintiff's Exhibit 1380.

MR. LONDON: If Your Honor would, please, again instruct the jury that this is not being offered for the truth of its contents and they shouldn't rely on its contents to prove the truth of what it says in the article.

THE COURT: All right. Are you going to offer both of these articles, Mr. Hogeland?

MR. HOGELAND: Plaintiff's Exhibit 7187, I believe it is, Your Honor, was, I believe, not in the pre-trial order. So I'm not offering that in evidence.

THE COURT: All right. Well, Plaintiff's Exhibit 1380, the *Business Week* article is something that you looked at and relied in part on. Is that correct?

THE WITNESS: Yes, sir.

THE COURT: All right. Ladies and gentleman of the jury, 1380 is admitted, not for the truth of any statements contained therein, and you shouldn't rely on the article for the truth of any statements therein but admitted as the type of information - public information available which the witness referred to and perhaps relied on.

(The article above
(referred to was received
(into evidence as:

(PLAINTIFF'S EXHIBIT
(NO. 1380.

* * *

[p. 47-78] But, for example, there's a quote here: "They can't live fact on happy anymore." And the last article - and I just wasn't quick enough on it to comment - that in

the Merrill Lynch analyst report this is a well-functioned oligopoly or whatever it is.

I mean, those are quotes by other people and whatever cautionary instructions given the jury, it's the sort of material that under 403 should not be coming in. If he's relying on financial information in here, that's a different story.

And, you know, we're very close to the lunch break. This article is a lot shorter than the other. I have seen it before but not for a long time, and ---

THE COURT: Well, we're taking an awful long time here on these things. I'm going to admit it as something he relied on. If he wants to rely on it and there's some problems on that, you can impeach him on something else.

Let's go ahead.

(End of bench conference.)

BY MR. HOGELAND:

Q Mr. Burnett, what in evidence in Plaintiff's Exhibit 1380 did you take into account in considering the profitability of the cigarette industry?

A Well, the article as a whole I took into account. There are two or three passages which have to do with [p. 47-79] profitability and the pricing structure in the industry.

The very beginning of the article, the first line reads, "The cigarette industry may have big woes, but it also has big profits." And then it goes on to discuss that these big

profits exist even in the face of the declining unit volumes that we've discussed a couple of times.

On the second page you see halfway down the first column the heading "Profits in Puffs." And a little way down there's a quote that begins, "Despite declining sales for the smaller producers, cigarettes are still a highly lucrative business with operating margins that can exceed 25 percent."

And then a quote, " 'Even with modest market share, you can be extremely profitable,' asserts Raymond J. Pritchard, chairman of Brown and Williamson Tobacco Corporation, the U.S. tobacco arm of London based BAT Industries PLC and the nation's third largest cigarette maker."

"Those profits are getting a boost from stable to lower prices for leaf tobacco coupled with a savings rung out of plant consolidations and modernizations."

And then the final passage that bears directly on profitability appears in the first full paragraph in the middle column which begins, "Some industry insiders ---" And it goes on to say, "Some industry insiders worry that the pricing skirmishes that could erupt." Or excuse me. "--- that the pricing skirmishes could erupt into a full-scale [p. 47-80] war."

That's referring, at least in part, in the previous paragraphs to generic cigarettes.

And then they go on to say, "Manufacturers increasingly are shifting marketing dollars into such promotions as two-dollar-discount coupons for cartons. The number

of such promotions quadrupled this year, distributors say. At Philip Morris, the nation's leading cigarette maker, the possibility of a price war is a major concern."

And then a quote, " 'Our biggest worry is that the competition doesn't get stupid,' says Frank E. Resnik, president of Philip Morris, U.S.A."

So in general this article is yet again confirming that the prices and profits in the industry are high and the quote from Philip Morris expresses concern that somebody doesn't get stupid. And to me as an economist that means that the price - that they don't want a price war to break out.

Q Mr. Burnett, you've told us yesterday that there were other forms of rivalry between the cigarette manufacturers besides list price competition. Would you tell us again what they are?

A Well, there are stickers and coupons and buy-one-get-one-free and other forms of free giveaways when new products are being introduced.

[p. 47-81] Q And does that mean that --- Does that reduce the profitability of cigarette manufacturers?

A To an extent, but the key issue to me is whether the extent of the promotional activities offset or compensate for the continual and steady increases in list prices.

And my evaluation of the data available indicates that it does not.

Q Well, Mr. Burnett what degree of competence do you as an economist have in using accounting rates of return to evaluate profitability in the cigarette industry?

A I use them with great caution. There are significant potential differences between the accountant's use of this type of data and accounting profitability and the measure of profitability that economists would, in a sense, prefer to have.

However, this is the data that is regularly available and regularly relied upon. It's used by economists in industry studies. It's used by investors and stock analysts and accountants and the trade press in evaluating a company's profitability.

So that although I recognize that they are potentially flawed and may not be perfect measures of profitability from an accountant - excuse me - from an economist's perspective, they provide significant evidence to me of the high prices and high profits that are earned by the cigarette [p. 47-82] manufacturers.

Q Well, how does an economist's evaluation of profitability differ from accounting reports?

A Well, accountants sometimes treat some forms of expenses as an example. There are a number of ways they may differ, but a very straightforward example is that accountants tend to treat certain forms of expenditures by a company as if they should be written off or deducted from income in the given year in which they are incurred, even though those expenses may have the effect of increasing the prices and the profits of the company over some long period of time.

Probably the best example of that is research and development. When a firm spends money on research and development, the accountant will expense it or

deduct it from income all in the same year, even though that research and development may well lead to sales and profits and revenues out into the future.

The economist would rather see those research and development dollars capitalized or kept as an investment on the firm's books rather than expensed or deducted all in the first year.

Accountants, though, are extremely conservative people. And since it's fairly uncertain as to whether the research and development will ultimately result in income, the firms engage in the R & D in the anticipation that it does.

[p. 47-83] But economists would really prefer to see it capitalized and treated as an investment rather than expensed. Accountants don't do it that way, and that's one possible difference.

There are others. So the data has - the accounting data has to be used with care and caution, and it has to be viewed in context.

And what I've tried to do here is look at a number of different sources and find them all generally consistent with the proposition that the returns to investments in cigarette activities are high.

The prices - and they confirm the position that prices charged for cigarettes are high, are above levels that would prevail in competitive markets.

Q Well, as an economist, what conclusions do you draw from the fact that the cigarette industry profitability is higher than in other - than other industries?

A In conjunction with the other information I've reviewed, including a high concentration and the price leadership and the inconsistent movements in prices and costs and now the profitability – I've reached the conclusion that prices and profits in this industry are above competitive levels and that that provides the motivation or provides or establishes the plausibility of potential predatory behavior on the part of one of the larger manufacturers with respect to Liggett [p. 47-84] and Myers.

Q Mr. Burnett, if there's an absence of competition in the cigarette industry and cigarette companies are making such high profits, why doesn't everybody begin making cigarettes?

A That's a good question because that's how market economies are supposed to work.

When firms in an industry earn profits that are above competitive levels, if the market is functioning properly – new firms will enter that business in an attempt to participate in those high profits that are earning more than you can get somewhere else.

And to an economist the next question is, how easy or difficult is it for new manufacturers to get into that business?

That's termed by economists an evaluation of conditions of entry or barriers to entry. And I looked at that, and I concluded that entry into the cigarette industry is very difficult. It's quite difficult. It has not occurred in many, many years, decades.

And there is good reason for that.

Q Well, Mr. Burnett, as an economist, what would you expect to see happen if entry into the cigarette were easy?

A As long as the profits and the prices are high, if entry were easy, I would have expected to see new firms entering the market to participate in those high profits.

[p. 47-85] If we took as an example again the carpet industry, if for some reason the production of carpet became a very profitable business activity, I would expect to see new firms opening carpet factories with some speed to participate in those high profits.

Q Well, would the conditions of entry in an industry affect an analysis of the plausibility of predatory conduct?

A Yes. It would.

If entry was very easy and occurred quickly in response to the high profits, then in a sense the existing manufacturers would have little to protect in the way of high profits because they were going to lose them fairly soon anyway.

If new firms will enter, then the prices aren't going to stay up here at the monopoly level for very long or at a monopoly-like level for very long because other people are going to come in and compete them away (demonstrating).

So the existence of or the difficulty of entry, the existence of what are sometimes termed "barriers to entry" provides the basis for believing that the high prices and profits will be sustained for a long period of

time and, therefore, that the existing manufacturers will have something to protect and defend.

Q Well, what did you conclude regarding entry conditions in the cigarette industry?

[p. 47-86] A Entry into the industry is difficult. It would take a long time and is unlikely.

Q Well, what do you base that conclusion on, Mr. Burnett?

A Well, it's in part based on a very simple observation, that even the existing manufacturers of cigarettes have a very difficult time successfully introducing new cigarette products.

There are only a few – a handful of products that have been introduced since the early 1970's that have achieved a share of three or four percent. They include, for example, Vantage and Merit which took advantage of the opening of the low-tar and nicotine category of the market. And they included Liggett's generics.

But the fact is that the big winners – the big hitters that achieve three or four percent are rare and unusual.

It's also true that a manufacturer of branded cigarette products cannot succeed in the long run with just a single brand of one percent.

Liggett's experience illustrates that in the late 1970's. As Liggett's share was declining below two and a half percent, it was on the verge of going out of business.

And the reason it was on the verge of going out of business is that one of the things a cigarette manufacturer

has to have to sell branded cigarettes is a sales force out [p. 47-87] there to support the sales and distribution of that product, as well as the requirements of having the manufacturing facilities and all of the overhead expenses to support them.

You can't succeed with just one or two percent of cigarettes sales. And the fact is that it's very hard to get one brand that will get you there.

Therefore, a new firm coming into the market would have to anticipate getting two, three, four successes all in a fairly short time frame or else they're going to be operating at a disadvantage compared to the other firms.

And that just typically hasn't happened. There hasn't been that many big winners.

And not only would a firm outside have to anticipate that they'd have a big winner, but they would have to anticipate before the large existing branded manufacturers anticipated the opening of a new category or the development of a new product that would appeal to a lot of different consumers. And that's just very unlikely.

Further, even if they did anticipate that big winner, it's likely that it would take a long time. If you look at the experience of a couple of the brands that have succeeded in gaining material market shares upward of three and three and a half percent, at least a couple of them took a long time to get there. They were introduced, and they were, in fact, successful brands, in the sense that they got one [p. 47-88] percent, a little more than one percent. That's a success in the cigarette industry.

But it took quite a number of years for even those successful brands to keep up so that they had sales that approximated two or three or four percent. So it's difficult to do. It doesn't happen often. In some instances it takes a long time.

And if a firm outside is going to do it, they've got to anticipate and get in there before one of the branded manufacturers does. That all to me means that it's unlikely that it will occur, and it provides a strong basis for explaining why it has not occurred.

Q Is the fact that industry demand is stable or declining affect new entry?

A Sure can. If you have a market environment where demand is growing. It means that in a sense there is room for the new firm to come in and participate or take sales from the growing market.

On the other hand, if the demand is stable or declining, it means that in a sense there's a fixed number of cigarettes that are going to be sold. And the new entrant has to come in and actually take all of its sales away from the existing manufacturers. That's a relatively more difficult prospect than coming into a growing market where you're likely to take some of your sales from existing manufacturers and also. . . .

* * *

[p. 47-96] and that it's quite difficult. And if it did occur, it would take a long period of time.

So it reinforces my view that in the presence of the high prices and profits, there is something for the existing branded manufacturers to defend.

Q Well, Mr. Burnett, if all of these cigarette firms have something to defend in exercising market power through coordination of activities, why would any of them want to engage in predatory behavior?

A I guess that's the point. Liggett was different, and Liggett had different motivations from the other five manufacturers by the time they introduced generic cigarettes.

As I was just saying, Liggett was on the verge of liquidation. Liggett was almost going out of business. Liggett broke with the traditional patterns of competition in the industry and for the first time in many, many decades used list price as a form of competition to sell its cigarettes.

Liggett was the one firm in the industry that had the strongest incentive to introduce low-priced cigarettes because in doing so it had little to lose in the form of the high prices and profits on branded cigarettes.

It didn't have many branded cigarettes any more. So to the extent it grew the cigarette - the generic category, it was pulling all of its sales from the other manufacturers and [p. 47-97] was suffering relatively little itself.

So there was a very marked difference in the motivations of Liggett and Myers on the one-hand and the other manufacturers on the other. Liggett didn't have anything to protect any more.

MR. LONDON: Move to strike, Your Honor.

THE COURT: Overruled.

BY MR. HOGELAND:

Q I understand your description that Liggett had nothing to protect, but you had mentioned a final and sixth factor in your industrial organization market analysis as the role of Liggett in the industry.

Now what do you consider the role of Liggett in the industry having to do with the plausibility of predation by anybody in the industry?

A Liggett was the spoiler. Liggett broke the rules of the game. In the presence of its declining share, Liggett introduced the generic cigarettes, and that ---

Q Well, Mr. Burnett, what evidence do you have that Liggett was the spoiler or maverick?

A It was, in fact, the firm that was the first firm to use list price as a competitive weapon in decades. It lowered the price of cigarettes to the consumer, and those prices were passed on to the consumer. And those low prices were what motivated, in large measure, the increasing sales of [p. 47-98] low-priced generic cigarettes.

Q Well, is Liggett's action with respect to generics the only evidence that you're relying on to define Liggett's role as a spoiler or maverick?

A No, sir. Liggett's role as the spoiler or maverick really predates generics and goes back to the mid-1970's when they attempted to introduce Eagle.

Eagle, at the time, was intended to be a discount cigarette. And I believe, as Mr. Dey and Mr. Grant both testified, it didn't succeed. And in part it didn't succeed

because they weren't capable of insuring that a significant enough price differential existed between branded product up here and Stride down here (demonstrating) to motivate the consumer to buy the product.

That product didn't succeed, but it indicated in 1975 -- Liggett ---

Q You mentioned Stride. Did you mean to say Stride?

A Excuse me. If I said Stride, I meant Eagle. We're talking about Eagle.

In 1975 Liggett made the first attempt to use a lower list price to sell its Eagle product. It failed. It didn't work. But it was the first indication of their willingness to try it, to make the attempt at introducing a lower-priced product.

They tried again in 1979 with their initial sales to [p. 47-99] Topco for generic cigarettes, and much to their surprise, it succeeded beyond all expectations. And as the Brown and Williamson documents indicate, it had reached a share of approximately four percent, which in volume terms is just a smashing success.

By early 1984 Liggett's role as the spoiler and the price-cutter didn't stop there.

Late last year or early this year they introduced yet another low-priced cigarette, this time the Pyramid product, which they are promoting as selling for about half the price of branded cigarette products.

So Liggett's role as the price-cutter and spoiler really extends over the entire period of 1975 through 1988-89.

Q Well, all right, Mr. Burnett. What does the role of Liggett and Myers as the maverick or spoiler that you have just described have to do with your industrial organization market analysis?

MR. LONDON: If Your Honor please, so that I don't have to keep getting up, may I have a continuing objection to the witness's characterization and to the witness's narrative?

THE COURT: All right, sir.

Go ahead.

A Liggett, as the spoiler, and Liggett, breaking with the rules of the game, provides the motivation for one of the [p. 47-100] larger firms to engage in predatory behavior with respect to Liggett.

It was Liggett that was having the effect of bringing down the price structure. It was Liggett that was having the effect of offering low-priced cigarettes to consumers and drawing those cigarette sales away from the high prices and high profits that were earned on branded cigarettes.

That meant that the larger firms had something to protect and defend, and it was Liggett that was undercutting the high prices and profits and, therefore, provided the motivation for one of the larger firms to come after Liggett in an attempt to slow down the rate of loss of branded sales to there [sic] lower-priced, lower-profit generic cigarette products.

Q Do you consider Brown and Williamson one of those larger firms?

A Yes, sir. I do.

Q Now, Mr. Burnett, do economists normally consider the role of an individual competitor within an industry when conducting an industrial organization market analysis?

A Yes, and specifically it's often called the role of the maverick firm. It's the firm that doesn't go along with the behavior of the other firms in the industry.

Q Do you remember testifying yesterday about the Department of Justice merger guidelines?

[p. 47-101] A Yes.

Q Does that have references in it to maverick firms?

A It doesn't use those words, but it has that --- It conveys the same spirit.

The Department of Justice merger guidelines say specifically that they will be more likely to challenge a merger and prevent industry consolidation and an increase in concentration where one of the firms involved is a maverick or disruptive force in the industry because it's precisely the loss of such a maverick or disruptive force that they're trying to prevent in addition to preventing the increase in concentration that results from a merger among firms that manufacture the same product.

Q Now, Mr. Burnett, did you find anything in any of the Brown and Williamson documents about the role of Liggett and Myers as a maverick?

A Yes. I did.

Q Now I show you Plaintiff's Exhibit 7097 which is in evidence.

MR. BARKER: Yes.

BY MR. HOGELAND:

Q And I will ask Ms. McCarty to give the jury copies of Plaintiff's Exhibit 7097.

Now, Mr. Burnett, can you tell me what Plaintiff's Exhibit 7097 is?

[p. 47-102] A This exhibit was an analysis as titled on the front page, "An Analysis of Price and Value for Money in the Cigarette Market" prepared by BAT, Brown and Williamson's parent corporation in England, of instances of the expansion of the value-for-money category or of price competition in a number of different countries around the world.

Those countries - the countries specifically that are analyzed are mentioned in the table of contents under number five on that first page.

Q Now, Mr. Burnett, that list of companies - countries on the first page, can you tell us what the first one is?

A Well, it's the United States. With respect to the United States and specifically with respect to the role of Liggett as the spoiler ---

MR. LONDON: I don't think there is a question pending, Your Honor.

THE COURT: All right, sir. He's listed the United States.

All right. What is your next question, Mr. Hogeland?

BY MR. HOGELAND:

Q What does it say about price competition in the United States?

A Well, with respect to Liggett as the spoiler on Stamp Number 216491 and, if you can read it, I think it's page 18 [p. 47-103] at the top of the page.

This document specifically recognizes the role Liggett and Myers has had in expanding the availability and sale of generic cigarettes in the United States. And under C, the second heading down on that page, it reads, "Liggett and Myers has been steadily declining for many years. By 1980 its market share was two and a half percent which was almost below the threshold at which they could remain in the marketplace.

"The cost and risk of new product launches plus the economic environment pushed them towards the product development of generics and own label cigarettes.

"Initially they were only 'on test,' but their success, backed by support from a new parent company" - Grand Metropolitan took over Liggett in 1980 - "encouraged further development and growth from 1981 onwards."

So their [sic] BAT is specifically recognizing the role Liggett had had in introducing generic cigarettes.

MR. LONDON: I object, and I move to strike the characterization of what this witness says BAT is recognizing.

THE COURT: All right. I will grant that. If you will just --- The document is in evidence, and the jury can draw their conclusions from that.

All right. Go ahead.

BY MR. HOGELAND:

[p. 47-104] Q Are there other passages and parts of this document about low-priced cigarette competition that relate to your industrial organization market analysis, Mr. Burnett?

A Yes, sir. Several pages further on, on Stamp Number 216494. I believe it's page 21 now. Near the bottom of the page, the second to last bullet at the bottom of the page that begins, "The presence."

And it reads, "The presence of a rapidly declining manufacturer, Liggett's, was important in the U.S. situation and is repeated in many other markets around the world. Its acquisition by Grand Metropolitan in 1980 was also a key factor in the traditional tobacco marketing strategy. It's also a key factor in that traditional tobacco marketing strategies were put aside."

Q And, Mr. Burnett, that bullet appears under the heading "Conclusions." Is that right?

A That's correct.

Q And that is conclusions with respect to what?

A It's their conclusions with respect to their analysis of price and value-for-money in the cigarette market, specifically with respect to competition in the United States.

Q Now, Mr. Burnett, are there other parts of this document that relate to your industrial organization market analysis?

A Yes. There are some summary statements back on page 12 [p. 47-105] of the document which is Stamp Number 216485.

Q And this is page 12?

A Page 12.

Q And you are referring to the page that begins, "The ideal preconditions"?

A That's correct. This is a summary of the lessons ---

MR. LONDON: Object to what it is, Your Honor. If he wants to read from the document in evidence on which he relied, Your Honor has ruled that he may do that. But I believe he may not tell us what it is he thinks the purpose or the meaning or the significance of the document is.

THE COURT: Well, I don't know whether he was going to tell us that or not, but you can go ahead.

I did not hear what you said or were going to say.

Is there a question, Mr. Hogeland? And you referred him to that page. What about it?

BY MR. HOGELAND:

Q This page begins, "Ideal preconditions." Is that right?

A Yes. It does.

Q Preconditions to what?

A As I interpret it, it is preconditions ---

MR. LONDON: Object to this, Your Honor.

THE COURT: Well, the document is in evidence. There is a possible problem with him interpreting documents. "Pricing Value of the Cigarette Market" appears to be the [p. 47-106] heading.

Go ahead. I'll let you testify to that. Go ahead.

A Let me just read what the document says then. The document is about the pricing value-for-money category of the cigarette market.

And they write under a heading titled "The Ideal Preconditions." Quote, "Experience tells us that every market has its own peculiarities which render it unique, but there are some common threads which suggest that the value-for-money phenomenon is most likely to occur when some or all of the following conditions exist." And then a colon.

And then if we look down, several of these preconditions are consistent with the observations I have already made about the cigarette industry in the United States including the one bullet about halfway down that says, "Where industry profit margins are high." And the next one, "Where one or more company is under pressure

from seriously declining market share." And the next one, "Where an aggressive or new competitor exists." And the next one, "Where a non-tobacco company buys an existing tobacco company," which is precisely what happened in 1979 or 1980 when Grand Metropolitan purchased Liggett and Myers.

Those are the preconditions that BAT set forth in their analysis of price and value-for-money in the cigarette market.

[p. 47-107] BY MR. HOGELAND:

Q And what role did you conclude that Liggett's position in the cigarette market played in your analysis of whether or not predation in the cigarette industry was plausible?

A Liggett's role as the price-cutter and Liggett's role in the use of list price competition provided the basis for one of the firms wanting to engage in predatory behavior with respect to Liggett.

Liggett was bringing down or held the potential to bring down the industry price structure which, at the time, was charging consumers high prices and was earning the manufacturers high profits.

MR. HOGELAND: Your Honor, this would be a good place to break for lunch.

THE COURT: All right.

Ladies and gentlemen, it is now 12:30, and there's a matter during lunch that the Court will have to consider with counsel. So we are giving you until 2:00 today.

Please remember what I have told you about keeping an open mind on the case and not discussing it.

Please leave your documents there, and I think we will be ready to resume at 2:00 o'clock.

All right, Marshal.

(Jury out at 12:30 p.m.)

THE COURT: All right. Now remember, some of you

* * *

[p. 47-109]

AFTERNOON SESSION
2:05 o'clock P.M.

THE COURT: All right, gentlemen. Anything before we bring the jury back in?

MR. LONDON: Our first team is still down with the Magistrate, but we'll plug ahead as best we can, Your Honor.

THE COURT: All right.

Marshal, if you would, please.

(Jury in 2:05 P.M.)

THE COURT: All right, Mr. Burnett, if you would come back, please, sir.

All right, Mr. Hogeland.

MR. HOGELAND: Thank you, Your Honor.

BY MR. HOGELAND:

Q Now, Mr. Burnett, before the lunch break, you had completed your sixth and last point of your Industrial Organization Market Analysis which was the role of Liggett in the cigarette industry. Now as an economist,

Mr. Burnett, what conclusion do you draw from the – all the six factors in your industrial organization market analysis?

A Very simply, that given the presence and the exercise of monopoly power or market power exercised by the large manufacturers of branded cigarette products, that the larger manufacturers with a significant stake in branded cigarette sales had the motivation to engage in predatory behavior. [p. 47-110] That establishes for me the plausibility of predatory behavior, and I guess the second point is that it made rational economic business sense to target Liggett and Myers as the target of predatory behavior because Liggett and Myers was having the effect of reducing cigarette prices by having introduced generic cigarettes in the early 1980's.

Q Well, Mr. Burnett, why in your opinion would predation by Brown and Williamson against Liggett and Myers have made sense?

A The large manufacturers of branded cigarettes were in a sense jointly sharing market power. The prices for all branded cigarette products were high and were being held above competitive levels, so all of the manufacturers who had a significant stake in branded cigarette sales had high prices and profits to defend. Brown and Williamson was one of those firms and, therefore, Brown and Williamson had high prices and high profits to defend. And those high prices and high profits were being undercut by the expansion of generic sales by Liggett and Myers. Liggett was drawing sales from Brown and Williamson which were earning Brown and Williamson substantial prices and margins and profits.

Q Well, Mr. Burnett, isn't it true that in the textbook model of predatory behavior predation makes sense only where a firm has a dominant market share?

A That's a textbook model of predatory behavior, but it [p. 47-111] pretty much misses the more general point. The essential feature, the essential quality that must occur for the rational exercise of predatory behavior by a firm is either the current existence of market power and the existence of prices that are already above competitive levels and therefore those prices may be – the effort would be to maintain those prices at the above competitive levels. Or the prospect of somehow gaining market power and in the future raising the prices to above competitive levels.

So while the textbook model of predatory behavior is usually formed in the context of a single firm with a very large share, that is by no means necessary for the rationality or for the plausibility of predatory behavior. The essential feature of it is the existence of and potential exercise of market power and in this instance the market power is jointly exercised by all of the larger manufacturers of branded cigarettes.

Q Well, Mr. Burnett, does it really make sense for a firm with as little as ten or twelve percent of the cigarette market to invest in predation?

A Yes, it does. Brown and Williamson, even though it had a share of quote, "only," closed quote, ten or twelve percent, had literally hundreds of millions of dollars at stake in their sales of branded cigarette products, and although they may have had less at stake in total terms than one of the [p. 47-112] larger manufacturers, the

amount of money at issue was huge. Hundreds of millions of dollars. So as long as they could protect and defend those hundreds of millions of dollars from imperision [sic] by Brown and Williamson, even though they weren't the largest firms, they still had material significant excess or monopoly profits to protect and defend and that provides them with an incentive and a motivation to go out and defend them to the extent they perceived they're being harmed.

Q Well, for predation against Liggett to succeed and permit the creditor to recoup that investment, would it be necessary to drive Liggett out of business or out of the generic segment?

A No. Predatory behavior can be successful on the one-hand if the firm – the price cutter is driven out of business, that would certainly be the ultimate. But it can also succeed simply by disciplining the competitor. In the context of generic cigarettes, indeed, all that is necessary is that the rate of growth in generic sales be reduced or slowed down. Even if generic sales continue to rise, if the behavior of one of the larger firms had the effect of changing the pattern of increase in sales or the trajectory of increase in sales so that they didn't grow quite as fast as they otherwise would have grown, in an opportunity cost sense, the firm engaging in the predatory behavior, loses less than they otherwise would have.

[p. 47-113] If we assume that no action is taken and Liggett grows the market by a percent a year, the firms lose a lot of money. If one of the firms take action and it costs them 15 or 20 million dollars to discipline and chasten Liggett as the maverick firm, and they slow that

rate of loss down to only half a percent a year – half a percent growth a year, then they've slowed down their rate of loss or rate of erosion in branded sales by half a percent. That's three hundred – or excuse me – that's three billion cigarettes. And the margins earned by the branded manufacturers on three billion cigarettes is a healthy substantial big chunk of money. So they don't have to put Liggett out of business. They don't have to absolutely reduce sales. Technically, all they have to do is slow down the rate of growth in generics and it would pay off.

Q Mr. Burnett, you used the term "opportunity cost." Can you tell us what you mean by "opportunity cost"?

A Well, in this sense, it's just a comparison of what the losses to the branded manufacturers would have been if they had taken no action in contrast to what the losses would be if they took action. And the point is that all they have to do is reduce the rate of growth by a little bit, from say a percent a year to a half a percent a year, and they avoid losing the extra half percent and therefore it would pay off. It would be worth the candle. They'd invest 15 or 20 million [p. 47-114] dollars, and as long as they avoid losing an even greater amount of money, it was worth it to them.

Q Well, Mr. Burnett, did Brown and Williamson analyze the market conditions it faced in 1983 and 1984?

A Yes, it did.

Q And do the Brown and Williamson documents created during that analysis contain economic facts about

the cigarette industry and Brown and Williamson's role in it and Liggett's role in it?

A Yes, they do.

Q Mr. Burnett, do economists regularly study and analyze business documents to understand the company's policies?

A Yes, on a regular basis.

Q Did you study and analyze B & W's documents and testimony?

A Quite extensively. Yes, I did.

Q What kind of business documents do economists pay attention to in doing that type of analysis?

A You pay attention, in essence, to the material that's available and the information one has available, but the weight one accords to documents is, at least in part, a function of who wrote them, who they were directed to, and what background and knowledge and information the author had when they wrote the document. For example, if a document is authored by the president of a corporation or the vice

* * *

[p. 47-121] Q What were the key features of Brown and Williamson's market analysis, Mr. Burnett?

A Well, not surprisingly, given the issue we have at hand, they key features of Brown and Williamson ---

MR. LONDON: Move to strike the "not surprising."

THE COURT: Well, let's don't --- Let's just say answer the question without speculating to that extent, please, sir. Go ahead. The key features were ---

A The key features that I focused on focused on Liggett and Myers' role in the generic category. The effect Liggett and Myers expansion of generic sales was having on Brown and Williamson and general activities within the generic cigarette category. I classified them into five general broad groups. The first involved consideration of the role Liggett and Myers generic cigarettes use of list price competition was having on the market and the distinctions that were drawn by Brown and Williamson between the use of list price and other forms of price competition.

The second has to do with the observations concerning Liggett and Myers commitment to the generic cigarette category and indeed their commitment to continue to drive or to expand the availability and size of the generic cigarette category absent some actions taken by some other firm.

The third category has to do with Brown and Williamson's observations of their losing more than their fair share of [p. 47-122] sales to Liggett and Myers generic cigarettes and the fact that if their loss of sales continued, the losses that they would incur would run into the hundreds of millions of dollars.

The fourth has to do with the observation that Liggett and Myers was so dependent on its generic cigarette sales, that it would vigorously defend those sales. That it was important to the future existence of the corporation. But that was tempered by the observation that the

resources that Liggett had available to it were limited and that Liggett would not be able to withstand a concerted competitive attack for an indefinite period of time. They didn't have the financial support and backing to continue its commitment to the generic category if it was seriously threatened.

And finally was the observation that a key feature of Liggett's program to expand the availability and sales of generic cigarettes was in maintaining and, whenever possible, increasing the price spread or gap between the price of branded cigarettes and the price of generic cigarettes. So in my economic analysis, those are the five key features that I identified in Brown and Williamson's corporate documents.

MR. HOGELAND: Your Honor, at this time, I'd like to ask Ms. McCarty to circulate to the jury a binder of documents, all of which are in evidence.

THE COURT: All right.

* * *

[p. 47-143] A Yes, I have.

Q What others are there?

A Well, the next one is - this time it is behind Tab Number Five, Plaintiff's Exhibit 5. The document written in mid-March 1984. And turning to the second page of the document, Stamp Number 086985, about halfway down the page, the document reads, "Unchallenged, L & M could continue its total dominance of this segment and grow to a total company share of over 15 percent by 1988, becoming the third largest company in the U.S. cigarette market, stipulating that the industry's interest, other than

L & M's would be far better served had generics never been introduced. They are an immediate and growing threat to all other manufacturers. Competitive counteractions are essential and inevitable."

And then continuing on under number three, "Competitive Response. Generic growth represents volume erosion for all competitors. Unchallenged, L & M will continue aggressive segment development since it has virtually no stake in the branded full price market. All other manufacturers face a shrinking industry and eroding share in volume as generics grow."

Q Now, Mr. Burnett, in your own market analysis did you conclude that generic cigarettes were a threat to all other manufacturers?

A Yes, sir. I did.

* * *

[p. 47-148] conclude, further down the page, under the heading "Competitive Activity" it reads, "Generic growth represents volume erosion for all competitors. Unchallenged, L & M will continue aggressive segment development since it has virtually no stake in the branded full priced market."

Q Mr. Burnett, are those packages[sic] that you just read from, the domestic competitive analysis, consistent with your own industrial organization marketing analysis?

A Yes.

MR. LONDON: Objection.

THE COURT: Overruled.

A Yes, they are.

BY MR. HOGELAND:

Q Now, Mr. Burnett, you testified that the third key feature that you discerned in B&W's market analysis was that Brown and Williamson was losing more than its fair share, and that if that loss continued it stood to lose millions of dollars. Are there documents in Brown and Williamson's market analysis that illustrate that key feature, Mr. Burnett?

A Yes, there are. In large measure, they're drawn from the same documents I've been reading from.

Q Can you tell us what they are?

A Yes, sir. The first one appears in PX-2, tab two, once again, the February 9 overhead presentation. And the point

* * *

[p. 47-151] A Yes, sir. Turning to tab five, Plaintiff's Exhibit 5, again, the March 9 Brown and Williamson generic proposal. On the second page of that document, stamp number 086985, in the third paragraph down the page, Brown and Williamson wrote: "B&W's contribution to generics was disproportionately high. Specifically, B&W contributes about 70 percent more than its fair share volume to generics. B&W losses account for about 21 percent of generic's gains. In 1983 B&W lost about 3.7 billion sticks to generics, a variable margin loss of over 50 million dollars. By 1988 this loss could total 18 billion sticks, and about 350 million dollars loss of variable margin."

And then down at the bottom of the page, it reads, "1988 - '83 Losses to Generics." "For perspective, in 1983 cigarette companies lost approximately the following volumes and variable margin to generics." And then there appears, at the top of the next page, a table which is repeated in a number of other Brown and Williamson documents, which basically shows where Brown and Williamson got the Fair Share Loss Index of 170. B&W was listed as the second firm down the table, and reading across to the second column, it says, "Fair Share Loss Index," and B&W's is 170.

What that means is that Brown and Williamson was - Brown and Williamson had a share of 11 or 12 percent, yet it was contributing more than 11 or 12 percent to generic sales.

* * *

[p. 47-157] THE COURT: Okay. Well, that's where illustrations come from. Let's don't have him go through 13,000 documents.

MR. HOGELAND: That's my whole point, Your Honor. He has selected these to illustrate those which he relies on.

THE COURT: Okay.

MR. LONDON: That's my understanding of the question.

THE COURT: Okay. That's fine. Let's sit down before we have an argument.

(End of Bench Conference.)

BY MR. HOGELAND:

Q Now, Mr. Burnett, before you were interrupted you were answering my question as to what, if anything, in Plaintiff's Exhibit 7098A illustrates the statements in Brown and Williamson's documents on which you rely for your conclusion that a key feature of its market analysis was that B&W was losing more than its fair share and stood to lose millions of dollars, or your first two key features, that Liggett was committed to the segment and continued to grow it and had a motivation to do it, or that price competition was new in the cigarette industry.

A Well, there are two key passages that highlight the role of price competition in the sale of cigarettes. The first appears in Mr. Kellegher's cover letter under the caption --- about three-quarters of the way down the page - entitled, [p. 47-158] "Pricing and Value for Money," where it reads, "The policies - " meaning, Brown and William [sic] - or BAT Company's new market expansion strategy paper policies. "The policies place a much greater emphasis upon the need to avoid price competition whenever possible and to undertake it only after careful evaluation of the consequences."

And then, subsequently, on page 14 of the document itself --- Excuse me. Thirteen. Page 13, at the very bottom. I believe it's stamp number 183883. At the very bottom of the page under "Policy."

"Every effort must be made to ensure that the industry operates and competes within a rational and profitable price structure." And then carrying over, "Operating companies will not lead or preempt down-trading other than in very exceptional circumstances, and with BAT

Company board approval. Operating company resists, wherever possible on an industry basis, the contract manufacturer of own label or generic cigarettes. No such manufacture should take place without BAT Company board approval."

"Price, slash, value for money offers will be avoided if at all possible; however, competitive moves of this nature should be countered swiftly and dominantly where failure to do so can be shown to be detrimental to the company's market position and profitability in the longer term, and after careful evaluation of all the consequences, including further [p. 47-159] competitive reaction."

"Efforts to maximize contribution by shaving product costs should be - " excuse me - "should be pursued, but without compromising consumer preference."

MR. HOGELAND: Now at this time, Your Honor, I would like to pass out to the jury another binder of documents, all of which I believe are in evidence. Is that right?

THE COURT: All right.

BY MR. HOGELAND:

Q Now, Mr. Burnett, you told us that the fourth key factor in Brown and Williamson's market analysis was that Liggett would vigorously defend its generic business but lacked the resources to withstand a competitive attack. Have you selected from Brown and Williamson's market analysis documents, those documents which illustrate the kinds of statements in there on which you relied for your conclusion, with respect to that key feature?

A Yes, I have.

Q Could you tell us what they are?

A Yes. The first one is in Plaintiff's Exhibit 9, behind tab 9 in the binder.

Q And what is Plaintiff's Exhibit 9, Mr. Burnett?

A It's a Brown and Williamson document entitled, "The Generic Cigarette Category."

* * *

[p. 47-162] that document, stamp number 095662 - really, the entire page and a portion of the next page is pertinent to this point.

MR. LONDON: May I just have that Bates Number again, please.

THE WITNESS: 095662.

MR. LONDON: Thank you, sir.

A "Generic Competitive Response: This section discusses possible competitive responses to the generic cigarette - generic segment." And then it heads it, "Liggett and Myers."

"In the absence of any direct competition, L&W [sic] will continue to build the generic category. It is almost certain that if Brown and Williamson entered the generic segment, Liggett and Myers will react vigorously. Generics represent about 60 percent of L&M's volume. Without generics, L&M's tobacco business would be irreparably damaged."

The next bullet is, "Liggett Can React. While Liggett may have more short-term capacity problems than any

other company in the industry, if they continue to increase market share, we know that they have ordered 17 high-speed cigarette makers, and that would provide them with more than four incremental marketing - with more than four incremental market share capability. The delivery schedule for this equipment is not known."

"We believe the following competitive scenario may be the most likely. One. L&M first meets Brown and William [sic] - [p. 47-163] Brown and Williamson's offer in the military and categories - in the military and categories one and two."

Just as an aside, categories one and two involve volume categories that B&W had laid out, and categories one and two involve purchasers who had purchased in the highest volume categories, or customers that made the largest volume categories - largest volume purchases. Excuse me.

"In addition, L&M may add full taste, kings and 100's to their product line and expand sales support. Expansion into full taste could pose a particular threat to Kool. If this happens, we believe Brown and Williamson still has a good chance of securing generic volume, due to our ability to provide better service and the belief that distributors and chains would prefer doing business with us because of our size and perceived stability."

"Brown and Williamson would match L&M's move to a full product line. If L&M goes to full sales support, Brown and Williamson would match customer service through one or more of the following: Temporarily borrowing the B&W sales force and possibly blitzing at

wholesale, slash, retail, increase permanent part-time help, and seeking additional broker resources."

Then briefly following on to the next page, page 54, under number three, it writes, "As such, under all likely scenarios, B&W stands to capture a major part of the segment. [p. 47-164] We would not expect L&M to be able to maintain any loss position long-term."

Q Now, Mr. Burnett, is there anything in the March 9th Brown and Williamson document that illustrates your point that B&W's market analysis showed that Liggett would react vigorously but had limited resources?

A Yes. In tab five, Plaintiff's Exhibit 5, once again the February - March 9 Brown and Williamson generic proposal. Turning to pages ten - ten and eleven. On page ten, half-way down the page it reads, "Liggett and Myers' Response. In the absence of direct competition, Liggett and Myers will continue to develop the generic category. When any cigarette competitor enters the generic category, L&M will almost certainly react vigorously. To survive a competitive entry, L&M can be expected to minimally match the competitive offer at least in the military and their largest volume accounts. Further, L&M may spend down to full variable margin, i.e., zero profit."

"Conservatively accepting the generics will attain about two million units in 1984 ---"

Q I'm sorry. That's "24 million."

A Excuse me. "--- about 24 million units in 1984, of which L&M might secure 20 million. It would cost L&M an additional 35 to 45 million dollars in lost variable margin to defend its business, assuming a competitor

entered in June and [p. 47-165] Liggett defended in the third and fourth quarter, and first by matching and then by going to a zero profit position."

Q Now, Mr. Burnett, your independent market analysis. Would you conclude that it would cost Liggett and Myers money to defend its position against a competitor who offered a lower price and then went to a zero profit position?

MR. LONDON: I did not understand that question, Your Honor.

THE COURT: Well, you may restate it, if you want to. I think I understand it, but go ahead and restate it.

BY MR. HOGELAND:

Q Do you understand, Mr. Burnett?

A I believe so.

Q Would you answer it, please?

MR. LONDON: I object to the form of the question. I would like to be able to follow it. I'm trying hard as I can.

THE COURT: All right. Go ahead and repeat it, if you would, Mr. Hogeland.

BY MR. HOGELAND:

Q Mr. Burnett, in your independent analysis of the cigarette business and the generic cigarette business, did you reach a conclusion that it would cost Liggett and Myers money to defend its business if a competitor entered and went down to a zero profit position?

* * *

[p. 47-171] Q Now, Mr. Burnett, when we broke, you were testifying about the Brown and Williamson market analysis documents that you had selected, illustrating the feature that Liggett would vigorously defend its generic volume but lacked the resources to withstand a competitive attack, and I believe you were on Plaintiff's Exhibit 5, which is tab five in your book at the top of page 11. Can you tell us what on that page illustrates that key feature?

A Yes, I can. Just a review. This is the March 9 Brown and Williamson generic proposal, and at the top of page 11 Brown and Williamson wrote, "Brown and Williamson would be prepared to match any improvement in service level or line extension. If L&M goes below full variable margin, Brown and Williamson would not match their offer. We would not expect L&M to be able to maintain a loss position for any extended period of time."

Q Now were there additional documents ---

MR. LONDON: I believe it says Brown and Williamson would not plan to match their offer.

THE COURT: I thought that's what he read. Maybe he didn't.

MR. LONDON: I thought he left the word "plan" out, but perhaps I'm wrong.

THE WITNESS: That's certainly there.

BY MR. HOGELAND:

[p. 47-172] Q Now were there other documents which you selected from Brown and Williamson's market analysis to illustrate that point?

A Yes, sir. In Plaintiff's Exhibit 6, which is behind tab number six in this volume, this is the "Brown and Williamson 1984 Strategic Plan and Ten Year Forecast," written on March 9, 1984, from Mr. McDonough, who I believe was the vice president for finance. If you turn to page 12 of the document, stamp number 147823, at the bottom of page 12, Brown and Williamson wrote, "In the absence of direct competition, Liggett and Myers will continue to develop the generic category. When any cigarette competitor enters the generic category, L&M will almost certainly react immediately and vigorously. However, it is unlikely L&M can, in fact, be prepared to engage in a sustained battle because it does not have the financial resources of others in the industry."

Q Are there other documents that you selected ---

A Yes, there are.

Q --- to illustrate that same point?

A Yes, there are, in Plaintiff's Exhibit 7, again behind tab seven of this document. This is a document we looked at earlier for purposes of evaluating the inconsistency of changes in prices and cost, and it was written by Mr. Blott, Senior Vice President of Liggett - excuse me - Senior Vice President of Brown and Williamson, on March 22, 1984. On [p. 47-173] page three of that document, stamp 087133, very briefly Brown and Williamson writes at the top of the page, "L&M will attempt to retain this

business but lacks financial strength to cover all fronts on a sustained basis."

Moving on, there was another reference to the same point. In Plaintiff's Exhibit 41, once again behind tab 41 --- Excuse me. That's incorrect. It's Plaintiff's Exhibit 10, the next document behind tab ten, a memo written by Mr. Fulk, who reported to Mr. Parrack, a vice president and who was the head of the generic's team. On pages four and five of that document ---

Q Excuse me, Mr. Burnett. What's the date of Plaintiff's Exhibit 10?

A Mr. Fulk wrote that document on April 26, 1984, and on the bottom of page four under B, Cons, number one, "This proposition may ---"

Q Mr. Burnett, can you tell me what the word "con" is referring to there?

A Yes. It's one of the cons or the negative aspects of generic, black and white and private label sales. If you turn back to page three, one can see that they are reviewing the details of the generic black and white private label enterprise for Liggett - for Brown and Williamson. It's on the bottom of page four and carrying over onto five. They write, "From the perspective of L&M, we would be competing [p. 47-174] directly with the major part of their total business. If a price war erupted, and if lower prices were passed on to the consumer, widening the price gap between generics and premium cigarettes, there is the possibility of increasing cannibalization."

Then moving over to the next page to number three, it reads, "Legal risks may be somewhat greater with this concept" - meaning black and white and private label generics. "To the extent that Brown and Williamson's offerings will be similar to L&M, we risk legal actions by that company."

And then number four, "While we are convinced that we can replace L&M because we will offer significantly better terms, there is obviously no guarantee that customers will take B&W's generic offerings, particularly if L&M matches or exceeds our terms."

Carrying on, the next reference appears in Plaintiff's Exhibit 31, behind tab 31. These were notes from the Project Volume Task Force meeting, dated Tuesday, May 22, 1984.

Q Excuse me, Mr. Burnett. What does project volume mean?

A Project volume, as I understand it, is the generic enterprise or Brown and Williamson's consideration of launching a generic cigarette. On the second page of that document or note at the very bottom of the page, "B&W fully expects L&M to file suit and to fight price competitively."

[p. 47-175] And then moving on once again to Plaintiff's Exhibit 61, behind tab 61, a memo from Mr. Diebold to Mr. Heger. Mr. Diebold was the Senior Financial Analyst, and Mr. Heger was the Chief Financial Officer of the firm.

Q And what's the subject of that memorandum, Mr. Burnett?

A It reads, "Liggett's Strategy in Regard to Generics," and it was written on July 26, 1984. On the third page of the document, Mr. Diebold writes in the summary, "Turning to the direct question asked, i.e., what will Liggett do and how long can they hold on, my thoughts are as follows. First, we already know that Grand Met is attempting to dispose of the tobacco business. The entry of B&W into the business has driven down the potential price for the business and has spoiled the financing for the leveraged buy-out. While the Liggett group is no doubt mad as hell and may desire to do anything to stop B&W, from Grand Met's viewpoint, they need to find a buyer and protect the potential selling price as much as possible. I would doubt that they would allow Liggett to continue to meet and beat our cigarette selling prices and will probably attempt to raise prices as soon as possible.

"In short, I believe that they have or will shortly decide to share the market with B&W and others. In the meantime, they will probably continue to search for a buyer. I fear that if B&W does not purchase Liggett, they could be [p. 47-176] sold to someone such as U.S.T. or Culbro.

"As to Liggett's staying power, if B&W continues to cut prices, they will be forced, in the short term, to meet our prices but not to beat them. They would count on B&W increasing price around the first of the year or sooner. If they can't find a buyer at any price, their long-term strategy would be to milk the entire business."

And then he closes by saying, "If I can be of further help, please let me know." Again, that was in July of 1984

after Brown and Williamson had introduced their generic cigarettes.

And finally, in document 83, behind tab 83 --- Excuse me. I'm wrong once again. It's document - Plaintiff's Exhibit 901, behind tab 901, the last one in the book. That is an internal memoranda from Mr. Parrack, the head of the Generic Task Force, to Mr. Sandefur on March 27, 1985, roughly nine or ten months after Brown and Williamson introduced its generic cigarettes. Turning to page five of that document, stamp number 086942, at the bottom of that page under, "The rest represent only two key questions. Will Grand Met keep Liggett afloat after June? Will Lorillard figure out what's right with Newport and apply that learning to new products? The first is the one that matters to us. How will Grand Met deal with a cash drain? Divest? Manage prices up? Fight to the death? Lacking financial data on [p. 47-177] Grand Met, we cannot project their actions."

Those are the references I believe - or I selected to illustrate the point concerning the vulnerability of Liggett to a sustained attack on their generic cigarette business.

Q Now, Mr. Burnett, the fifth key feature that you testified to that was contained in B&W's market analysis - was Liggett's part in expanding the generic cigarette category through maintaining and increasing the gap or the spread between branded cigarettes and generic cigarettes?

Now, Mr. Burnett, you selected documents from Brown and Williamson's market analysis to illustrate that point?

A Yes, I did.

Q Can you tell us what they are?

A Yes. The first one is included in Plaintiff's Exhibit 9, again behind tab nine. It is the document entitled, "Generic Cigarette Category." And if you turn to page 068640, page 13 of the document, the second bullet on the page reads, "Starting in 1983, L&M abandoned their previous low-profile marketing strategy and pursued a more aggressive plan encompassing in-store and media promotion, which included ---" and then another bullet "--- widening and emphasizing price difference between branded cigarettes and generics when Liggett decided not to raise generics prices."

That highlights a key feature of Liggett's proposal, of Liggett's generic enterprise. Liggett did not raise price [p. 47-178] when the tax increase went into effect in 1983. This is a clear reflection of the understanding of industry members that they did not raise price, kept the price down, and that was a key feature involved in increasing the sales of generic cigarettes.

There is also reference to this issue in Plaintiff's Exhibit 4, behind tab four. Once again, this is the write-up to the February overhead presentation written in late February or early March, and on page 15 of that document - the stamp number is 095624 - at the top of the page, "L&M Generic Strategies. L&M rapid development in the generic segment has resulted from a number of key strategic decisions. These include, one, taking advantage of marketplace dynamics by widening the price differential between branded cigarettes and generics. When L&M chose not to raise price during the general price increase

in December 1982, July 1983 and again in December 1983, at which time the federal excise tax was doubled, share gains were immediate and dramatic."

Once again, clear recognition that the increase in the price gap when Liggett chose not to raise prices on generics dramatically fueled the expansion of generic cigarette sales.

MR. LONDON: Motion to strike as to what it's a clear recognition of, Your Honor.

THE COURT: All right. The jury will disregard [p. 47-179] that last remark. They've got the document before them. Go ahead. Next question.

A The final document that illustrates this point regarding the effect of the price gap between branded and generic cigarettes appears in document 83, behind tab 83. This is a memorandum.

BY MR. HOGELAND:

Q Can you tell us what that document is, Mr. Burnett?

A This is a memorandum from Mr. Sandefur to Mr. Frigone, an executive of BATUS, the U.S. parent or superior company to Brown and Williamson, on March 21, 1985. And on page ten of that memorandum, stamp number 078501, Mr. Sandefur wrote, towards the bottom of that page, "L&M has limited cash, slash, resource availability."

And then under "Strategic Direction," "L&M will try to survive by ---" and then several bullets "--- raising prices on generics, sharing the generic segment with

B&W, other niche marketing ---" and then new bullets "--- mid-price products and ethnic products." And then a new bullet, "Grand Met will continue to try to sell L&M."

Those are the selections I picked to illustrate the importance of the price gap between branded cigarettes and generic cigarettes in expanding and fueling the growth of the generic category.

Q Now, Mr. Burnett, based on Brown and Williamson's market [p. 47-180] analysis, do the B&W documents set forth a plan or program by which a company might enter the generic cigarette business?

A Yes, it did.

MR. LONDON: Objection and motion to strike.

THE COURT: Overruled.

BY MR. HOGELAND:

Q On the basis of your analysis of that plan and program, do you have an opinion as to whether or not, if implemented, that plan or program had a reasonable possibility of injuring competition?

A Yes, I do.

MR. LONDON: Objection.

THE COURT: Overruled.

BY MR. HOGELAND:

Q What is that opinion?

A That if implemented the program described in these documents had a reasonable possibility of injuring competition.

Q Mr. Burnett, what are the elements or factors in that program that lead you to that conclusion?

A There are several. The first element of the program is a proposal to match list price, but in a sense to beat Liggett's price by offering volume rebates that differed according to the volume of purchase that were discriminatory in that they granted higher rebates to larger volume [p. 47-181] purchasers. This was adopted in part to prevent the price decrease that would accrue to the direct buying customer from B and ---

MR. LONDON: Motion to strike as to the purpose of its adoption, Your Honor. This is precisely the point that we discussed before.

THE COURT: Well, sustained as to why it was adopted unless you've got some specific document that is in evidence that you rely on and make reference to.

THE WITNESS: There will be, Your Honor.

BY MR. HOGELAND:

Q Can you tell me --- The first element on which you relied in your conclusion was a program to match the list price but beat through discriminatory rebates. Is that right?

A That's correct.

Q And what was the next element?

A The next element is essentially one that is intended to narrow the price spread or the gap between branded and generic cigarettes to either reduce the rate of growth of generic cigarettes or, if possible, to actually decrease the sales and availability of generic cigarettes.

Q And what was the third? What was another factor that you found in that program and on which you based your conclusion that, if implemented, it would injure competition?

[p. 47-182] A The discriminatory rebate structure that was adopted or that, if adopted, would have harmed competition was a form of predatory behavior which, if adopted, would have had the effect of minimizing ---

MR. LONDON: Motion to strike.

THE COURT: Overruled.

A --- would have had the effect of minimizing the cost of engaging in predatory behavior.

BY MR. HOGELAND:

Q And were there any other factors that you found in that program on which - as revealed in the documents - on which you based your conclusion that if implemented it would have the effect of injuring competition?

A Yes, sir. The final one is that, if adopted, the program would have had the effect of setting prices below the average variable costs of producing and distributing generic cigarettes.

Q All right, Mr. Burnett. Going back to the first factor that you listed, the program of matching list price but beating Liggett through rebates. Are there Brown and Williamson market analysis documents that illustrate this element of the program?

A Yes, there are.

Q Can you tell us what they are?

A The first one is Plaintiff's Exhibit 275, which is the. . . .

* * *

[p. 47-195] MR. LONDON: That's not - if Your Honor please, we've been over this so many times.

THE COURT: We are getting into intent again. Go ahead, Mr. Hogeland, and try one more time to ask the question, please, sir.

BY MR. HOGELAND:

Q I'm not asking you about Brown and Williamson's intent, Mr. Burnett. It's my understanding of your prior testimony that you concluded that the program disclosed in B and W's market analysis documents for entering the generic cigarette industry, would in your opinion, injure competition in part because it would narrow the price gap between branded and generic cigarettes and reduce the rate of growth of generics, is that correct?

A That is correct, but I would go farther in saying that what would be necessary is merely to slow the rate of growth in generics. Not necessarily to decrease the gap. All they had to do was slow down the rate of growth; not narrow the gap. If the gap would have grown to 50 percent or 70 percent, the category would have grown even faster. All they had to do was keep it from going from 40 to 45; and the predatory campaign could have still paid off.

Q Now are there documents in B and W's market analysis that you have selected and on which you rely to illustrate that point?

* * *

[p. 47-197] A. . . . is Plaintiff's Exhibit 4 at Tab 4, yet again, the write-up or written description of the February overhead's presentation at Page 22, Stamp Number 095631, and it's headed, "Brown and Williamson Generic Objectives." "Year One, become a dominant factor in the generic market targeting for at least a 60 percent share of the generic market at the end of year one. Given that the company cannot be certain how quickly volume will be established, we project it - we project that volume falling into 1984 will be between three point seven and six billion sticks detailed in the financial section." And then, "Out years. Maintain dominance of the generic market, at least a 60 percent share of the generic market. Other key long-term objectives are to manage segment growth; limit potential for competitive entries by minimizing profit capability; minimize generic erosion of B and W existing business; minimize the version of B and W resources, and then human financial and manufacturing."

And then it concludes, "These objectives will be achieved while other full major margin brands are being developed for marketplace implementation." And, in the same document, turning to Page 41, Stamp Number 095650, under the heading, "Financial Generic Long-Term Pricing Strategy." "B and W's long-term pricing strategy is as follows. Manage the category growth by preventing an increase in the percentage pricing spread between generics and branded cigarettes. This [p. 47-198] will be accomplished to be one of the following tactics depending on the environment at the time of price increases. Maintain a constant percent margin difference at 40 percent between the prices." And then there's a reference to a financial schedule, which comes in later pages.

And the second point is, "Allow the percentage difference to decrease by maintaining a constant dollar spread." With again reference to a following financial table that comes later in the document. Turning the page to Page 42, it reads, "A further explanation is as follows. Schedule one maintains a generic price increase which is 60 percent of the expected increase on B and W branded cigarettes. Although this will increase the dollar spread between generics and branded, the percent difference remains constant. Consumers will not have an increased motivation to trade off image for price as has been the case with L and M not increasing their prices on generics when branded product prices increased."

Q Mr. Burnett, let me interrupt you. Can you explain how an increased dollar spread would not increase the percent spread in talking about the price difference between branded and generic cigarettes?

A Well, if I understand you correctly, you could have a difference of a dollar, between nine and ten dollars, being a ten percent reduction from the ten-dollar price. That's ten percent. If the price is then increased to twenty dollars

* * *

[p. 48-32] reference, attached are the speech and support material compiled for Mr. McCarty's use at the CAC meeting."

Mr. McCarty was an executive with BATUS, BAT United States, and the CAC is the chairman's advisory

committee which is an advisory committee of BAT Industries in England, the parent company of both BATUS and Brown and Williamson.

BY MR. HOGELAND:

Q And for the record, Mr. Burnett, when did Brown and Williamson enter the generic cigarette segment?

A They began shipping product in July of 1984. They began soliciting accounts in June of 1984. This document was written in April of 1985, a little less than a year after that.

And if you turn - just turn one page to the page with the stamp number 138773, halfway down the text portion of the page Brown and Williamson wrote, "B and W's entry and pricing policies within the generic and private label segment will attempt to maximize the profit opportunity available from this market segment. B and W's goal is to improve profits from this segment through a combination of significant production cost reductions and price increases. B and W would hope to reduce the spread between generics and full price productions if we could do so without reducing its share of this segment. B and W's presence within the segment appears to have resulted in reduced consumer advertising by [p. 48-33] L and M, and a slowing in the segment's growth rate."

So after about 10 months in distribution, Brown and Williamson was writing that its presence within the segment appears to have resulted in reduced consumer advertising by L and M, and a slowing in the segment's growth rate. That statement is connected to the statement

we began with this morning that concerned entering the military section ---

MR. LONDON: Objection. I object to the witness's statement about what he thinks the document was connected with.

THE COURT: All right. Sustained.

BY MR. HOGELAND:

Q You testified earlier this morning, Mr. Burnett, about what your view as an economist was, what it would mean if a firm diverted the resources of its competitors; is that right?

A Yes, sir.

Q Now is the passage you just read consistent with your opinion as to the effect of diverting resources of a competitor?

MR. LONDON: Objection.

THE COURT: Overruled.

A Yes, it is. Brown and Williamson wrote in March that it was entering the military market to divert competitive resources from the civilian market.

[p. 48-34] The final document I selected to illustrate this point is Plaintiff's Exhibit 1374, behind - it's the last tab of this volume.

BY MR. HOGELAND:

Q Did you not select Plaintiff's Exhibit 954?

A Excuse me. I'm sorry. I missed one. It was hiding on me. The second to the last tab in this volume, Plaintiff's Exhibit 954. It is covered by a letter from Mr. Sandefur to Mr. McCarty and Frigene of BATUS on April 19, 1985, and it's, "Per your request, here's some information about the proposed generic pricing strategy as discussed in New Orleans."

And turning one page to stamp number 02697 - it may be 802697 - but the page is headed, "Generics," Brown and Williamson wrote, "B and W's pricing strategy has been to take the leadership in announcing a price increase in 1985, provided we are tracking to the 8.6 billion unit volume objective for 1985. As we are running behind our volume objectives, we are not in a position to lead a price increase, and have therefore reassessed our pricing strategy.

"It is our current belief that L and M, because of margin erosion, will initiate a price increase on the order of \$1.50 per thousand around mid-year 1985. To generate volume and improve our market presence, our position is to hold off taking a price increase for three months from the time L and M announces. Having improved our market presence [p. 48-35] during these three months, we would initiate a price increase of \$2.50 per thousand. We further anticipate that L and M, again because of margin erosion, would immediately increase their prices to parody [sic] with B and W."

And then at the very bottom of the page, the last paragraph reads, "B and W's long-term strategies in generics continued to be focused on margin improvement and to establish franchise equity through package design, et cetera."

And now to the final document I selected to illustrate this point, it is document - Plaintiff's 1374, the last tab in the book, and it is information covered by a memorandum from Mr. Bacon, who is the controller of the company, to Mr. Blott, who was the senior vice president, and several other vice presidents who were copied under the CC label, written in August of 1985. And the subject was the 1986 domestic marketing guidelines.

And turning a couple of pages to a page with the stamp number 233628, about halfway down the page, there is an underlying passage, "Generics," and the first issue under "Generics" addressed is, one, "Manage segment growth and profitability by gradually reducing percent difference between generic and full revenue brands."

That completes the documents I selected as illustrative of Brown and Williamson's statements targeting Liggett and. . . .

* * *

[p. 48-65] can get the jury and have the witness come back.

All right, Mr. Belvin.

(Jury in at 11:25 a.m.)

THE COURT: All right, Mr. Burnette. If you'll come back please.

BY MR. HOGELAND:

Q Now, Mr. Burnett, in the cigarette industry in 1984 if a significant cigarette manufacturer entered the generic segment without reducing list price, with a package that looked like Liggett's, with a discriminatory volume rebate program, with a program designed to capture existing demand for generics and not create new demand for generics, and prepared to spend variable margin - as variable margin was defined by Brown and Williamson, would its conduct have, in your opinion, a reasonable possibility of injuring competition?

A Yes. It would.

Q In your opinion, would such a plan make rational business sense?

A Yes. It would.

Q Why?

A In my view, as I testified - I guess the day before and yesterday - prices charged for branded cigarettes are above competitive levels. The large branded cigarette manufacturers have monopoly level profits and prices to [p. 48-66] protect and defend.

Liggett was the price-cutter. And in an effort to protect and defend its high prices and high profits on branded cigarettes, one of the large manufacturers had an incentive to target Liggett, to go after them, and to pre-date with respect to Liggett and Myers, to slow the rate of erosion of branded cigarette sales that Liggett was imposing on all of the other manufacturers in the industry.

Q Well, would it be a key element of the business rationality of such a plan that it included a way to limit the cost of predation?

A No one ever wants to spend more than they have to to accomplish a predatory result.

Q Was [sic] the amount spent on predation or invested in predation affect the ability to recoup the investment in predation?

A Yes. It does. The smaller you have to invest to accomplish your result, the less you have to recoup. If you can accomplish your result with ten million dollars or fifteen million dollars, all you have to do in the cigarette industry is slow down the rate of loss in branded cigarettes so as to preserve or maintain the margins on branded cigarettes that would equal fifteen million dollars plus a little more.

Q Now, Mr. Burnett, in the cigarette industry in 1984, if [p. 48-67] a significant cigarette manufacturer entered the generic segment, again without reducing list price, with a package that looked like Liggett's, with a discriminatory volume based rebate program, with a program designed to capture the existing demand for generic cigarettes, not create new demand for generic cigarettes, and actually spent variable margin - as that term is defined by B & W, would such conduct, in your opinion, in fact, have injured competition?

A Yes. It would.

Q How?

A There are a couple of ways it could have achieved the objective of slowing the rate of loss or the rate of

erosion in branded sales, and I've come to think of it in two different ways; one from the perspective of the predator and one from the perspective of the firm that's being targeted - in this case Liggett.

From the perspective of the predator, it's what I call a win/win strategy. A predator targeting Liggett with matching list price and a discriminatory volume rebate schedule could have won in one of two ways.

It could have succeeded in taking a substantial chunk of the generic business and, therefore, be in a position to raise the price of generic cigarettes and narrow the price spread between branded and generic cigarettes, thereby making generic cigarettes a less attractive alternative to the [p. 48-68] consumer and probably resulting in - at least in a decrease in the rate of growth in the category if not an actual decrease in the level of generic sales.

So one way to accomplish the objective is to take control of the segment, to manage the price up and to decrease the price spread between the two types of products.

In the alternative, the other way they can accomplish the same result of narrowing the price spread, which is the other half of the win strategy, is that in entering the generic category and in making offers that go down to full variable margin, which is the manufacturing cost of making those cigarettes, they can impose very large disproportionate losses on Liggett and Myers.

Liggett was, as we all know from the testimony here, the principal and largest seller of generic cigarettes. If Liggett chose to match the low prices, Liggett was going

to eat it. Liggett was going to eat the losses. It was going to incur losses that were disproportionate to the firm that was making the price offers.

B & W lowers the price to the customers, and Liggett matches. B & W has a small – relatively small volume of sales compared to Liggett, and the losses imposed on Liggett are even greater.

So Liggett's faced with one of two options. Either they fold up their tent and go home and they give the generic [p. 48-69] segment to somebody else, in which case that somebody else – Brown and Williamson – is in a position to raise the price. Or Liggett and Myers absorbs the losses and is, in a sense, forced to raise the price themselves to reduce the cash outflows that are being imposed on them.

And I believe there's been some testimony that the cash outflows, as a result of B & W's conduct just for 1984 for matching the volume rebates, was on the order of 35 million dollars.

And Brown and Williamson recognized and knew full well that Liggett couldn't sustain or withstand that kind of attack for very long.

So from the perspective of the predator, it was win/win. Either they controlled the category and lead prices up, or they impose the losses on Liggett, in which case Liggett will raise the price because they can't continue to absorb the losses.

MR. LONDON: Move to strike everything after what Brown and Williamson recognized.

THE COURT: Overruled.

A From the perspective of Liggett, the firm that was being targeted, it was lose/lose.

Liggett's very existence in the early 1980s was predicated on the existing ---

MR. LONDON: Your Honor, is there a question [p. 48-70] pending here?

MR. HOGELAND: Yes. He's still answering a question.

MR. LONDON: Well, it was so long ago that I've lost track of it.

THE COURT: Well, he's asked him how it would have injured competition. He said --- I believe he is getting ready to answer another way in response to that question.

Go ahead.

A From the perspective of the firm that was targeted – in this case Liggett – the way the campaign was launched against them with a matching of list price and discriminatory volume rebates and a package that looked extremely similar to its own, it was lose/lose.

They could have folded their tent and gone home and just exited the generic category or significantly reduced their presence in the generic category. And since its very existence was predicated or had been predicated on generic sales, that was a very difficult thing for them to do. It would have seriously jeopardized the firm.

Their alternative, though, was to match the volume rebates in order to keep some of the volume that was

keeping their company in operation. But from their perspective that meant they had to suffer all of the losses because they had the relatively higher share.

[p. 48-71] So it's win/win on the part of the predator, and it's lose/lose on the part of Liggett and Myers.

That from my perspective as an economist is the genius of the scheme, matching list, discriminatory rebates is win/win for the predator, lose/lose for the target.

MR. LONDON: Move to strike "the genius of the scheme."

THE COURT: All right. The jury will disregard that remark. The question, of course, assumed at the beginning - the preceding question assumed if certain facts were true, and that is what he's answered.

Go ahead.

BY MR. HOGELAND:

Q Now, Mr. Burnett, would the discriminatory scheme - the discriminatory volume based scheme make such a predator better able to afford and carry out a predatory scheme?

A I believe it would.

Q Now you told us yesterday - or I guess it was Tuesday - that there were six significant cigarette manufacturers in the cigarette industry. Is that right?

A Yes.

Q Was Brown and Williamson one of them?

A Yes. Brown and Williamson has been the third largest manufacturer for some time.

Q Now, Mr. Burnett, did Brown and Williamson enter the

* * *

[p. 48-83] A In my opinion, yes, they did.

BY MR. HOGELAND:

Q Now, Mr. Burnett, assuming that the significant - that Brown and Williamson's package looked similar to Liggett's, would that make predation more or less plausible?

A In this context it makes it more plausible.

Q You stated earlier, Mr. Burnett, that Brown and Williamson priced generic cigarettes below average variable cost. Did you study the question of whether or not Brown and Williamson actually priced below average cost for its generic cigarettes?

A Yes. I did.

Q And what did you conclude?

A I concluded that Brown and Williamson did price below variable cost from the period July 1984 through December of 1985 by almost 15 million dollars.

Q Did you cause an exhibit to be prepared setting forth that conclusion?

A Yes. I did.

Q I show you Plaintiff's Exhibit --- I show you Plaintiff's Exhibit 3066R ---

THE CLERK: Is it 39 or 30?

MR. HOGELAND: It is a nine. 3966R.

BY MR. HOGELAND:

Q And I ask you if that is the exhibit ---

* * *

[p. 49-42] Q Now you've shown us your monthly columns, and we looked briefly yesterday at Plaintiff's Exhibit 3966-R. And tell us again what that is.

A That is the summary data of the price and cost or the revenue and cost calculations for the entire 18-month period from July of 1984 through December of 1985. And once again, it shows that the net revenues to Brown and Williamson after subtracting excise tax and trade and DAIP rebates was about \$71,300,000.00.

To produce - to manufacture and distribute that quantity of cigarettes over that 18-month period, Brown and Williamson laid out variable costs of \$86,275,000.00, and that put Brown and Williamson \$14,961,000.00 below their average variable costs of producing the [sic] distributing generic cigarettes.

Q And once again, Mr. Burnett, I show you Plaintiff's Exhibit 3967-R, and I ask you what that is.

A That is the same data that is presented in 3966-R, except that here I calculated a per carton rate. The average revenues after those various costs up on the top - or those various expenses of taxes and rebates, came to about \$1.42 per carton for the 18-month period. And Brown and Williamson, by my calculations, spent \$1.72 in

variable costs, and therefore priced their generic cigarettes 29.8 cents per carton below variable cost for the 18-month period.

Q Now, Mr. Burnett, I call your attention to Plaintiff's

* * *

[p. 51-115] Q And if an economist were to tell us, and we accepted his testimony, that activity in the sale and the marketing of generic cigarettes had a downward influence on the price of branded cigarettes, then that influence would result in a gap smaller than it would have been but for that influence. Correct?

A Yes. And I would have chosen to illustrate what had happened in this industry in a completely different manner.

Q And, in fact, you told His Honor and the ladies and gentlemen of the jury here just an hour ago, didn't you, that you were firmly of the opinion that that did happen. That is to say, the effect of the generic marketing activity caused a lowering in the price of the branded product from where it would have been but for that activity.

A Absolutely. And but for the behavior of Brown and Williamson, the price of branded cigarettes would have been even lower.

Q And, in fact, you have no model, no formula, no scientific analysis that tells us exactly to what extent - strike the word "exactly" - to what extent the influence of generics has brought down the price of branded.

MR. TOPMAN: Objection, Your Honor. No foundation.

THE COURT: Overruled.

A Let me make sure I understand.

BY MR. LONDON:

* * *

[p. 54-96] Correct?

A I'm sorry. It's getting kind of late. You said it's possible that ---

Q It's also true, is it not, moving from the hypothetical, that generic cigarettes are not a market as we have defined a market in our previous questions?

A It's my belief that the sale of all cigarettes is the relevant market.

Q All right, sir. And does that mean that you agree with us that generic cigarettes, that's not a market. Correct?

A Correct.

Q All right, sir. And that is for the same reasons that king size cigarettes in the hypothetical are not a market because of this thing that I've called substituteability. Right? As you put it, the consumer can demonstrate the willingness to move from one product to another.

A Yes.

Q Now indeed you have told us it is your conclusion that the price --- On the issue of substituteability,

the price of the generic cigarettes affect the desirability of that product as compared to the branded product. Correct?

A I think that's true. The greater the difference or the smaller the difference in the differential in price between branded and generic cigarettes --- Well, whichever way it goes, it will affect the number purchased of each type.

[p. 54-97] Q And for that reason and the reasons we've just discussed, a manufacturer of one segment of the cigarette market - be it the generic segment, the filter segment, 100 millimeter segment - cannot be said under any facts, that you know of, to have monopoly power or market power in that segment because that's not a relevant market and because their substituteability or willingness of the consumer to move over to another product. Correct?

A I think that's true, but would you please say it again? I'm not --- I view the market as the sale of cigarettes because there typically will be substitution among the different types and styles of cigarettes.

Q Therefore, it's true, is it not, that a manufacturer in one segment of the market of all cigarettes - be that a particular price segment or style segment, whether it's 85's or 100's or black and whites or branded generics - cannot be said to have monopoly power in that segment because that segment is in the market and he can't control supply and price.

A I think as a general matter that's true, but ---

Q All right. Now ---

A --- that's solely for purposes of market definition for merger enforcement.

Q All right.

A It doesn't necessarily tell you anything about the . . .

* * *

[p. 56-139] after some period of time.

Q And what were Brown and Williamson's terms?

A I believe it was two percent, 12 or 14 days.

Q So there's a difference of one and a quarter percent?

A One and a quarter or one and a half.

Q And could you tell us what one and a quarter percent of the list price of \$18.75 was?

A Yes, just a second.

I come up with 23 cents, but somehow that doesn't seem right.

Q Well, that's what I get, too, but I think it's - my good colleague here tells me that that's a thousand - eighteen seventy-five. So that's four and a half cents a carton. Right, sir?

A That sounds better - 4.7 cents.

Q So that a customer - Okay. Let's go on.

Now do you agree, sir, that when Brown and Williamson came out at the 30-cent - the zero to 30-cent set

of brackets, that that schedule was not a predatory schedule, as you would define that?

A The net prices that would've resulted from that schedule are very, very unlikely to have put them below average variable cost.

Q So that the first offer they made was not what you as an economist would call predatory. Correct?

[p. 56-140] A It would not have resulted in their pricing below variable cost. I have a hard time separating what the original schedule was from their expressed statement that they were willing to spend a great deal more, and price below variable cost.

Q Well, I know some of these concepts are very hard for you, sir, and some of them hard for me, too, but I wish you sure would try to answer my question. And that is that you agree that the first offer that they made - the zip-to-30 offer was not as you would define "predatory" - a predatory offer. Correct?

A If that had ever been instituted and any product had ever been sold under that price schedule, it would not have put anybody below average variable cost.

Q All right, sir.

Now in your examination of the numbers in this case, what you have done and presented to the ladies and gentlemen of the jury is give us your opinion of the costs and revenues over Brown and Williamson's costs and revenues, as you've seen them, relating to the generic product over an 18-month period. And then, I think you said, you divided by 18 to get the average monthly figure. Is that right, sir?

A In one chart, I did that.

Q And in one chart you divided by 18 to get the average monthly figure. And then in another chart ---

* * *

[p. 58-153] Q . . . "I want to know, sir, if you testified under oath that the cigarette industry is not a collusive oligopoly."

Answer: "That is correct.

"Now was it the truth?"

Answer: "To the best of my knowledge, yes, sir.

Question: "And did you say, sir, under oath, that the price of branded cigarettes is a combination of elements, including cost of goods, competitive environment and taxation?"

Answer: "The price of cigarettes based on the cost of manufacturing, the cost of marketing, the taxation - they all go into the price, yes. They all go into the price, yes."

Question: "And so it's nothing but a fair price, right, sir?"

Answer: "I don't really understand what you're driving at. I'm sorry, sir. What's a price or an unfair price based on the way you word it, yes, it's a fair price."

Now you've read that testimony in reaching the opinion that you have reached in this case. Is that right, sir?

A Yes, I did.

Q Now in the course of your testimony you have, on any number of occasions, have you not, used the phrase "prices above competitive levels" or "prices higher than competitive levels" or "monopoly profits," "profits above competitive levels." You've used that series of phrases a number of

* * *

[p. 58-160] Q Okay. Now I want to direct your attention to a few other pieces of evidence and ask you some questions about it.

On July 19, 1989, Part IV, page 12, Mr. Dey was asked a question, "You described this industry, sir, as late as 1989, as a highly competitive and aggressive industry, did you not, sir?"

And the answer was, "Yes, sir, in terms of - I've expressed the competitiveness of our industry."

And were you aware, sir, that in 1989, Mr. Dey testified before the United States House of Representatives? Were you made aware of that prior to your testimony here?

A Yes.

Q And ---

A I've read it.

Q You are aware that Mr. Dey told - in 1989 - a committee of the - on Energy and Commerce at the House of Representatives - that he told the United States Congress that the cigarette industry was, quote, "a very, very highly competitive business," closed quote?

A Yes, I did read that.

Q And that on another part of his testimony before the Congress of the United States or a committee he said, "This is a highly competitive business. We fight tooth and nail."

You're aware of that?

A Yes.

[p. 58-162] Q Yes, sir. I'm sorry.

A Okay.

Q From the deposition of Mr. Dey dated March 13, 1987, page ten.

Question: "Do you agree or disagree that the major United States cigarette manufacturers, including Liggett, have reaped excessive profits from the sale of cigarettes?"

Mr. Dey said, "I disagree."

Question: "Do you agree or disagree that the major United States cigarette manufacturers have reaped monopolistic profits from the sale of cigarettes?"

Mr. Dey disagreed.

On the next page, "Do you agree or disagree that the prices of cigarettes sold by distributors have been fixed, raised, controlled, and maintained at non-competitive levels?"

Answer: "I disagree."

Question: "Do you agree or disagree that the public has been denied the benefits of free and open competition in the market place in the sale of cigarettes?"

Answer: "Read it again, please."

Question: "Do you agree or disagree that the public has been denied the benefits of free and open competition ---"

"I disagree," is the answer.

The question continues, "--- in the sale of branded cigarettes?"

[p. 58-163] Answer: "Disagree."

Page 14, question. "Do you consider that Liggett's rate of return on branded cigarette demonstrates that Liggett shares monopoly powers with other tobacco companies?"

Answer: "No."

Question of page 16: "In your opinion, Mr. Dey, does Liggett make monopoly profits on its branded cigarettes?"

Answer: "No."

Question: "In your opinion, do the other tobacco manufacturers make monopoly profits on their branded cigarettes?"

Answer: "As I define it, no."

Question: "In your opinion, does Liggett make higher than competitive profits on its branded cigarettes?"

Answer: "No."

Page 18. Question: "In your opinion, does Liggett price its branded cigarettes at higher than competitive levels?"

Answer: "No. Well, whatever - no, we don't. No."

Question: "Do you agree or disagree, Mr. Dey, that there is some form of tacit agreement with respect to branded cigarette prices among Liggett and its competitors?"

Answer: "I disagree."

Sir, did you read that testimony --- Listen to my question, please. Did you read that testimony before you

* * *

[p. 58-169] THE COURT: Overruled.

A Yes, and it's important that I explain again what that means because you've now asked me the same question in about six different ways.

To me tacit coordination and tacit collusion means that the firm successfully managed to get the price above levels that would prevail under competition. We can call that a pickle, or we can call that an agreement.

It is a tacit agreement. It constitutes tacit collusion, and we could define that as a pickle if we wanted, and as long as we all understood what it meant, that prices were raised above competitive levels without the firms ever getting together and discussing it; that's what would be important.

Q All right, sir. Now I want to read to you some testimony that Mr. Grant gave in this courtroom on the

subject you and I have been discussing. And, not surprisingly, in the questioning of Mr. Grant, nobody spoke about pickles.

On July 24, 1989, Part III, page 49 --- I'll get it up on the screen so you can follow it easier. Mr. Grant testified --- Starting at the bottom, Julie, all the way down at the bottom. The last line on the page.

"Do you have any understanding with any representative of any tobacco company as to what price Liggett would charge [p. 58-170] for its branded cigarettes?"

Answer: "No, sir."

"To your knowledge, has any other officer, director, or employee of Liggett ever entered into any kind of an agreement with a representative of any other tobacco company to fix the price on branded cigarettes?"

Answer: "No, sir."

"Are you aware of any agreement between any of the other United States tobacco companies to fix the prices that are charged for branded cigarettes?"

Answer: "No, sir."

"To your knowledge, has Liggett and Myers ever been approached to join any sort of agreement to fix prices on branded cigarettes?"

Answer: "No, sir."

"Does Liggett have any understanding with any other tobacco company as to what price it would charge for its branded cigarettes?"

Answer: "No, sir."

"Do you know of any such agreement among any other manufacturers?"

Answer: "No, sir."

Question: "Does Liggett have any unwritten or unstated understandings with other tobacco manufacturers to coordinate the prices which it charges for branded cigarettes?"

[p. 58-174] "I disagree."

And on Page 52, Question: "Do you agree or disagree that cigarette manufacturers are engaged in tacit collusion to fix prices on branded products?"

Answer: "I disagree."

Now, sir, you've told us that you read that in reaching your conclusion?

A Yes, I did.

Q Now when Mr. Dey, you recognized, and Mr. Grant made those statements both in the depositions and in the trial, they were speaking under oath?

A Yes, they were.

Q And you recognized that Mr. Dey and Mr. Grant were responsible - well, Mr. Dey was president of the company in '79, '80, '81, '82, '83, '84, '85?

A Yes.

Q And the highest operating official of the company?

A Yes.

Q And Mr. Grant was the number two man in the company?

A I guess you could call him that. Mr. Turner, who runs the factory, is also an important manager of the firm. And Mr. Welsh is the chief financial officer.

Q And you are aware, are you not, sir, that Mr. Dey and Mr. Grant were personally involved in the setting of the prices at which Liggett were going to sell and did sell its branded [p. 58-175] cigarettes?

A That was one of the reasons I wanted to discuss precisely those questions and answers with them, and that's why I did discuss it with them.

Q Do you know of anybody else in the Liggett and Myers company who was there in '79, '80, '81, '82, who had more responsibility, more hands-on line responsibility for setting the prices for Liggett branded products than Mr. K. v. Day or Mr. Hal Grant?

A The only reason I'm hesitating is that I'm not sure whether or not Mr. Grant had a superior at that time. He would have been a superior entity person manager in the sales organization.

Q Well, let me ask you this question, sir. Do you know of anybody in the organization of Liggett who had any more hands-on responsibility for setting cigarette prices in the late '70s and early '80s than Mr. K. v. Dey?

A He certainly had to approve them.

Q Do you know anybody who had more responsibility than he did?

A No. He'd ultimately have to sign off on price increases.

Q He had the final word?

A Yes, he did.

MR. LONDON: I have no more questions. Thank you, sir.

* * *

[p. 59-27] 7330, is that right?

A I've forgotten --- that one is 7330.

Q And by "that one," you mean what I've just identified as your recalculation of the generic assets; is that right?

A Yes. And the inventory chart was Plaintiff's Exhibit 7331.

Q Now, Mr. Burnett, are there other factors that make your minimum damage calculation, based on your return of assets approach, conservative?

A Yes, there are.

Q Can you identify some of those other factors for us?

A Well, again, the damage calculation cuts off in December of 1985. If there had been continuing effects or lingering effects after that, the damages would have been higher, is the key one.

Q Now you testified on cross examination that your return on asset calculated for Liggett's minimum damages was an attempt to determine what Liggett might

have earned but for B and W's anti-competitive behavior; is that correct?

A Yes.

Q Is that an accurate statement, that it determined what it would have been but for B and W's anti-competitive behavior?

A Well, it is a calculation that would reflect all forms of legal behavior or legal competition, so that it reflects and takes into account the potential effects on Liggett of, for [p. 59-28] example, Doral and the other low-priced cigarettes that were introduced at about that time.

Q And, Mr. Burnett, in fact, you testified that Liggett lost money on its generic cigarettes during that period, did you not?

A Yes, they did.

Q And did you take that into account in calculating the minimum Liggett damages for purposes of your return on assets calculation?

A No. I did. I basically started it at zero, and had I reflected the fact that they had actually lost money on their generic enterprise, the damages would have been, again, yet higher.

Q Now, Mr. Burnett, you also testified both on direct examination and then again on cross examination that the 89.6-million-dollar measure of Liggett's damage based on rebates constituted what you called an upper bound; is that correct?

A Yes.

Q And you testified that that 89.6 million was a conservative calculation of Liggett's damages; is that correct?

A I believe so. It left out a great deal of the competitive response to, for example, Doral.

Q And you also are aware, are you not, that Liggett and

* * *

[p. 59-72] Q And you relied on that testimony and that data. Is that correct?

A Yes. I did.

Q Now, Mr. Burnett, you did conclude, did you not, that one of the effects of Brown and Williamson's entry into the generic cigarette business was to divert Liggett's resources from advertising generic cigarettes. Is that right?

A Yes.

Q And you relied on that conclusion, in part, for your opinion that Brown and Williamson's conduct had injured competition. Is that correct?

A Yes.

Q I show you, Mr. Burnett, Plaintiff's Exhibit 20 which is in evidence.

MR. HOGELAND: And I'll ask Denise to pass up copies of Plaintiff's Exhibit 20 to the jury.

BY MR. HOGELAND:

Q Now, Mr. Burnett, did you rely on any Brown and Williamson documents for your conclusion that Brown and Williamson's entry into the generic cigarette business had resulted in a reduction of Liggett's consumer advertising?

A Yes.

Q I call your attention --- Let me first of all ask you, what is Plaintiff's Exhibit 20?

A This is a memorandum from Ms. Trina Olges to a number of [p. 59-73] the senior executives of Brown and Williamson in April of 1985. And it reads on the front page, "For your reference, attached are the speech and support material compiled for Mr. McCarty's use at the CAC meeting." Mr. McCarty was a senior officer, executive at BATUS or B & W's parent.

Q And you read testimony here that the CAC meeting was the chairman's advisory committee meeting. Is that right?

A Correct.

Q Of British American Tobacco. Is that right?

A Of BAT in England.

Q Now I call your attention to Page 138773 of Plaintiff's Exhibit 20. And I will ask you to read the last sentence in the next to the last paragraph of Plaintiff's Exhibit 20 on that page.

A Yes. Let me make sure I've got the right passage. It's the first bullet, the first indented paragraph.

And the last sentence reads, "B & W's presence within the segment appears to have resulted in reduced consumer advertising by L & M and a slowing in the segment's growth rate."

Q And when was that statement written, Mr. Burnett?

A April of 1985.

Q And that was how long after Brown and Williamson had established a presence within the segment?

A Nine or ten months.

[p. 59-74] Q Now you agreed - you came to the same conclusion that is stated there on Plaintiff's Exhibit 20, did you not, Mr. Burnett?

MR. LONDON: Objection.

THE COURT: Sustained. Your witness.

BY MR. HOGELAND:

Q Now, Mr. Burnett, you recall during your cross examination that Mr. London asked questions on several different days about the subject of whether or not rebates paid to the direct buying customers are passed through to consumers?

A Yes.

Q Now in your opinion, and based on your analysis and study of this industry, Mr. Burnett, did the rebates paid by B & W and by Liggett and by Reynolds, with respect to Doral, get passed through into the price consumers paid at retail?

A As a general matter, they did not. A very small amount of them may have been passed through, but as a general matter, the price at retail is a function of the list price and does not reflect the rebates.

Q All right. Mr. Burnett, I would show you ---

MR. HOGELAND: --- and I would ask Denise to pass out to the jury copies of Plaintiff's Exhibit 4269.

BY MR. HOGELAND:

Q Now I ask you, Mr. Burnett, to tell us what Plaintiff's [p. 59-75] Exhibit 4269 is.

A This is a memorandum for Mr. Christensen - although the name isn't very legible here - to Mr. Blott with copies to some of the other members of the sales organization of Brown and Williamson, authored in February 1985.

And it discusses or assesses on the second page the relationship as measured by Mr. Christensen between the list price for both branded and full revenue - I'm sorry - full revenue and generic cigarettes, and the ultimate consumer cost per carton. That's the price the consumer pays.

Q Well, going back to the first page, it says, "The attached analysis compares what has happened to retail carton and pack prices," does it not?

A Yes. It does.

Q Now did Mr. Christensen, when he calculated retail price of generic cigarettes, did he pass through any rebates to the retailer?

MR. LONDON: Objection as to what he did.

THE COURT: Well, what the figures show. If that's the question, you may answer.

A What the data shows is that consistent with the earlier years, there were no rebates passed through. In the calculation performed by Mr. Christensen, the computation begins with the list price of branded and generic cigarettes, and performs a series of computations adding state taxes and [p. 59-76] wholesaler markups and retailer markups to estimate the cost to the consumer or the retail price.

And what one notices is that going from 1983, when there were no rebates, to 1984 – or actually in 1984, in January, there were no rebates. In January of 1985, when there were rebates, this analysis essentially assumes that no rebates are passed on to the consumer.

There are no rebates reflected here anywhere in deriving the consumer cost per carton or per pack.

Q Now this analysis uses average state taxes, does it not?

A Yes. It does.

Q And do they change over time?

A Yes. Mr. Christensen has them in here as increasing from a dollar ten per thousand in January of 1980 increasing gradually to a dollar twenty per thousand in January of 1985.

Q And this analysis also uses standardized wholesaler and retailer markups, does it not?

A Yes. It does. It assumes that the markup at wholesale is 7 percent and that the markup at retail is 11 percent.

Q And then Mr. Christensen points out that you should use this for directional advice only, does he not?

a Yes. He does.

Q And he states, does he not, that the results vary greatly depending on state taxes and customer markup policies. Is that right?

[p. 59-77] A Yes. He does.

Q And there's no reference about results varying because of rebates. Is that right?

A No. There is not.

Q And as you pointed out earlier, there were periods of time covered by this analysis where rebates were in effect and periods where they were not. Is that correct?

A Yes. The principal comparison would be January '83 and January '84 to January '85 when there were substantial rebates in effect for generic cigarettes.

Q And just while we're on this document at this time, Mr. Burnett, can you read the last line which shows – sorry – the third from the last line – which shows the difference per carton as a percent of full revenue cigarettes?

A Yes. And if we look, it's really three calculations up from the bottom. It says, "Difference per carton as a percent of full revenue."

Reading across from 1980 through 1985, the percent difference is 30.1 percent in 1980, 26.4 percent in 1981, 30.4 percent in '82, 29.6 in January of '83, 34.1 percent in January of '84, and 33.3 percent, I believe, in January of 1985.

Q Now, Mr. Burnett, I show you what is in evidence as Plaintiff's Exhibit Number 7.

MR. HOGELAND: And I will ask Ms. Coleman to pass

* * *

(The document above
(referred to was marked
(for identification as:

(PLAINTIFF'S EXHIBIT
(NUMBER 7335.

[p. 59-117] Q Now I show you once again Plaintiff's Exhibit 4298. Does that show what the increase in king size branded cigarettes was in June of 1989?

A Yes. Between January and June of 1989, the list price of the king cartons or the kings per thousand went up by another \$2.50. If we annualize that and just hypothesize, not assert, but hypothesize that it increased by another \$2.50 this December, the increase this year would have been \$5.00.

Q And that would be at an annual rate of \$5.00, going up \$2.50 from January to June. Is that right?

A Yes, it would.

Q Now, Mr. Burnett, yesterday Mr. London read you a lot of testimony from Mr. Dey and Mr. Grant here in this trial and then also from their depositions. Do you recall that?

A Yes, I do. It was at the end of yesterday.

Q Now you previously testified that in your opinion the firms in this industry may be able to tacitly coordinate their behavior and approximate the result of a monopolist. Is that right?

A Yes.

[p. 59-118] Q Now Mr. London asked you questions about your opinion that there is this tacit collusion in the cigarette industry. And he asked you whether you took Mr. Dey's and Mr. Grant's testimony and deposition testimony into account in reaching your full conclusion. Is that right?

A Yes.

Q And you offered to explain how you had, but he didn't ask you. And I'm asking you now. How have you taken that into account when reaching your conclusion?

A Well, I read those depositions with some care. And I took it into account in the following way. It is typical. It's usual for economists and businessmen to use words in somewhat different fashion.

With respect to the passages that were read from Mr. Dey and Mr. Grant, the differences in the way an economist views things and the way a businessman talks about things can be broken down into, I guess, three general categories.

The first has to do with the interpretation of profitability and whether prices and profits are, in a sense, as I use it, for both competitive levels or not. And businessmen and economists frequently don't understand those terms and those concepts in quite the same way.

Further, when you talk to a businessman about tacit collusion or agreement, even if you say the word "tacit," they tend to think that you mean overt collusion which is a [p. 59-119] criminal offense. You can't get together in a hotel room ---

MR. LONDON: Your Honor, I object this speculation about what other people may think.

THE COURT: All right. Sustained to that part.

A There's a misunderstanding. There's a failure to essentially meet without ---

MR. LONDON: I object to this testimony about specific or a general effort to psychoanalyze the rest of the business community about what they think, Your Honor.

THE COURT: All right. If you're explaining why you did not consider Dey and Grant's testimony in a particular way ---

Is that the question, Mr. Hogeland?

MR. HOGELAND: That is the question, Your Honor.

THE COURT: All right. But businessmen generally - I mean, if you're testifying that you didn't think they knew what they were talking about or understood the terms, you may testify to that effect.

A That's essentially the point. Economists and businessmen tend to use those terms and those concepts differently. And unless you discuss something specifically back and forth and explain to the businessman what it is you mean by those phrases and by those terms, there is frequently misunderstanding.

That's something that I have experienced in almost the [p. 59-120] last fifteen years in doing this kind of work, that when you talk to a businessman, if you use technical, economic terms, you have to explain what you mean. Otherwise, it's like ships passing in the night.

And it's my belief that that's what was occurring with respect to the testimony of Mr. Dey and Mr. Grant. They don't use those words in the same way an economist does. Indeed, I discussed those concepts and those terms subsequently with Mr. Dey and Mr. Grant and we have a meeting of the minds.

MR. LONDON: Objection to this.

THE COURT: All right. Sustained to the subsequent discussions.

BY MR. HOGELAND:

Q Now, Mr. Burnett, I show you what I've marked as Plaintiff's Exhibit 7316, for identification ---

(The document above
(referred to was marked
(for identification as:

(PLAINTIFF'S EXHIBIT
NUMBER 7316.

BY MR. HOGELAND:

Q --- 7315, and I ask you, if you can tell me what they are.

* * *

[p. 59-128] BY MR. HOGELAND:

Q Mr. Burnett, is what you have just testified, about the different use of terms by economists and businessmen, something that is recognized by accepted economic authority?

A Yes, it is. It is recognized by anybody who does any work like this for any period of time and really ever carries out a substantive [sic] interview with a business executive. And it is recognized in the economic literature as well.

Q Now on your cross examination Mr. London read to you from a book by -- what I believe you called Professor Dr. Mike Scherer; is that right?

A Professor Scherer; yes.

Q And is there anything on this subject in Professor Scherer's *Industrial Market Structure and Economic Performance*, which I've just handed you?

A That bears on this issue?

Q That bears on this issue -- anything on this subject?

A Yes, there is.

MR. HOGELAND: I mark this as Plaintiff's Exhibit 5333.

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(referred to was marked
(for identification as:

(PLAINTIFF'S EXHIBIT
(NUMBER 5333.

Q Can you tell us what is in Plaintiff's Exhibit 5333 [p. 59-129] on this subject?

A Yes. In the second chapter of the book titled, "The Welfare Economics of Competition and Monopoly," there is a passage that refers specifically to this issue. Professor Scherer in the beginning [sic] of the chapter is discussing the economist's concept of competition. And on page ten in the second column he writes, "This technical definition of competition differs markedly from the usage adopted by business people who, following Adam Smith's lead, are apt to perceive competition as a conscious [sic] striving against other firms for patronage, perhaps on a price basis, but possibly also or alternatively on nonpriced grounds. Failure to recognize these implied semantic distinctions has often led to confusion in policy discussions. To keep such confusion at a minimum, we adopt the term 'rivalry' to characterize much of the activity business people commonly call competition."

I think that captures it. Professor Scherer is recognizing the difference in the way businessmen and economists tend to use technical terms such as competition.

Competition to an economist has implications that bear on such things as the number of firms competing in the market, the structure of the market, the conditions of entry into the market. Whereas, when you use the word

"competition" with a businessman, they typically will turn their mind immediately [p. 59-130] to things such as advertising and new product introductions.

Those are, of course, things economists take into account, and indeed I have here. The only point is that when you talk to somebody you've both got to be on the same wave length; you've got to be on the same page. In this case it would have been on page ten, so that we understood the distinction between the economist's use of competition and the businessman's.

But unless you understand the potential distinctions, there is the possibility of confusion and mischief.

Q Mr. Burnett, as an industrial organization economist, based on your study and analysis of the cigarette industry, have you concluded that branded cigarette prices are above competitive levels?

A Yes, I have.

Q And based on your study and analysis of the cigarette industry, have you concluded or inferred that overt or explicit collusion or greed or conspiracy exists among any of the cigarette manufacturers, with respect to cigarette prices?

A No, I have not. I have seen no evidence of overt or explicit conspiracy.

Q Now, Mr. Burnett, a week ago Mr. London asked you on cross-examination some questions about Reynolds - R.J. Reynolds Tobacco Company's entry into the low price

* * *

[p. 60-127] A . . . volume accounts.

"Further, L & M may spend down to full variable margin, i.e., zero profit. Conservatively accepting that generics will attain about 24 billion units in 1984, of which L & M might secure 20 billion. It would cost L & M an additional 35 to 45 million dollars in lost variable margin to defend its business. Assuming a competitor entered in June and Liggett defended in the third and fourth quarter, first by matching and then by going to a zero profit position."

Q Now, Mr. Burnett, did you - have you previously in your direct examination read that paragraph to the jury?

A Yes, I did.

Q And did you take that paragraph into account in reaching the conclusions that you expressed in your examination?

A Yes, I did.

Q In what way?

A Well, the statements about spending or "It would cost L & M an additional 35 to 45 million dollars just in the last six months of 1984 to defend its generic business." is half of the win/win-lose/lose strategy. Liggett had the option either of defending the generic business, in which case they would lose a heck of a lot of money --- Indeed, this is 35 to 45 million dollars just in the last six months.

Recognizing that they could not sustain those losses, Liggett would have its resources diverted and would be [p. 60-128] harmed. Liggett's alternative was to give up the game and to cede control of the category to Brown and Williamson, in which case Brown and Williamson would be in a position to raise generic prices and narrow the gap and decrease the sale of generic cigarettes.

So this 35 to 45 million dollars is one-half of the win/win strategy. Either Liggett gives up and gives control of the category to B & W, or Liggett tries to defend its position in the category and sustain its very, very large losses until it is no longer in a position to continue sustaining them. In which case, they give up the game anyway. So this paragraph really reflects one-half of the win/win strategy. From Liggett's perspective it's a lose/lose strategy.

Either they defend and lose a lot of money, or they give up the game and go home, in which case they are harmed because they lose the generic volume and the generic business.

MR. HOGELAND: I have no further questions, Your Honor.

THE COURT: All right. Anything as a result of this additional questioning, Mr. London?

RECROSS EXAMINATION

BY MR. LONDON:

Q As a matter of economic theory, did Brown and Williamson

* * *

[Excerpt Of The Trial Testimony Of B. Bacon]

[p. 61-172] Mr. Bacon, you prepared January, 1986?"

A "If that's the date that's on there."

Q "And you concluded in this document that Brown and Williamson, for the year 1985, lost a trading profit of 1.6 million dollars on generics?"

A "If that's what the schedule indicates."

Q "It says that, doesn't it?"

A "That's what it indicates, yes."

Q "For the period July through December, 1984, you concluded, did you not, that Brown and Williamson lost money on its generics in the amount of \$400,000.00?"

A "That's what the schedule shows."

Q "And you prepared the schedule?"

A "I did."

Q "And did you also conclude that for the period July, 1984, to December 31st, 1985, that Brown and Williamson lost two million dollars on its generic cigarettes?"

A "That's what the schedule shows."

Q "And you prepared the schedule, correct, sir?"

A "That is correct."

Q "Are you familiar with the phrase 'low-price cigarettes'?"

A "I am."

Q "What does it mean to you, sir?"

Q "It means pricing below what I call full revenue

* * *

[Excerpt Of The Trial Testimony Of K. Elzinga]

[p. 61-212] A "Kenneth Gerald Elzinga."

Q "Just because a business strategy is motivated from a desire to make money, doesn't mean that a business strategy is nonpredatory, does it?"

A "May I have that one again."

Q "Just because a business strategy is motivated from a desire to make money, doesn't mean that a business strategy is nonpredatory, does it?"

A "No, of course not. A predatory strategy is designed to make money."

Q "Must a victim of the predatory pricing be driven out of business for there to be predation?"

A "No."

Q "Do you agree that predation could be successful if the targeted competitor reduced its competitive efforts in response to a predatory price?"

A "By reduce its efforts, do you mean reduce its presence in the market, cut back on output, raise price, that sort of thing?"

Q "Yes."

A "Then I think my answer is yes, if yes means predation could be successful."

Q "Does the term 'oligopolistic market' mean anything to you?"

A "Yes."

* * *

[Excerpt of the Trial Testimony of D. Mills]

[p. 61-216] whether B&W priced its generic cigarettes above average variable cost, what is your answer?"

A "Insofar as by 'priced' you are only looking at the direct sales revenue on generic cigarettes, and are excluding, for instance, tax benefits, other financial benefits that the company enjoyed by producing generic cigarettes, the issue is different."

Q "Did B&W price above or below average variable cost in 1984 and 1985?"

A "Pretax trading profit was negative. Therefore, if you disregard financial consequences other than direct sales revenues in what you refer to as price, the answer would be that prices are below average variable cost."

Q "Do you consider the cigarette industry to be an oligopolistic industry?"

"Now?"

A "Yes."

Q "Do you believe there is tacit collusion in the cigarette industry?"

A "I would like for you to define what you think it means."

Q "Have you ever used the term?"

A "I am very careful not to ordinarily. It confuses my students."

Q "Has there been any type of collusion in the cigarette industry, in your opinion?"

[p. 61-217] At which point Mr. Peck asked, "Are you talking about now?" And I said "yes".

A "I am not aware of any collusive activity in the cigarette industry at present."

Q "What type of structures in industry indicate that collusion might be more likely than not?"

A "Other things the same, I think a collusion is more likely to occur and survive with few firms."

Q "Is collusion more likely in a highly concentrated industry?"

At which point Mr. Peck asked, "What do you mean by highly concentrated?" And I said, "Herfinahl index of more than 2,000."

A "Other things equal, for industries that are very highly concentrated, collusion is more likely than for industries that have very little concentration."

Q "Do you consider the cigarette industry to be highly concentrated?"

A "It's a very concentrated industry."

Q "Does 'barriers to entry' mean anything to you?"

A "Yes, it does. Two things. They are distinct categories."

Q "What are they?"

A "Sometimes entry barriers are referred to as any financial obstacle to entry that an entrant must incur. At [p. 61-218] other times, entry barriers are referred to as

any obstacle that an entrant must incur than an incumbent firm either does not or has not in the past had to incur."

Q "Do you believe that there are high barriers to entry in the cigarette industry under either of those definitions?"

A "Entry to the production of cigarettes?"

Q "Yes."

A "By a firm not currently producing cigarettes?"

Q "Correct"

A "I think that by the definition that any financial outlay is an entry barrier, that entry barriers for a firm outside the cigarette industry are relatively high."

Q "What about the second definition? Aren't they even higher in the second definition?"

MR. LEFELL: Can you read that again.

MR. RASMUSSEN: Yes.

Q "What about the second definition? Aren't they high even under the second definition?"

A "I don't believe they are."

Q "Why not?"

A "I don't believe there are costs associated with producing and marketing cigarettes that a potential entrant would have to incur that existing firms do not incur or have not in the past incurred."

Q "In trying to determine whether there are above [p. 61-219] competitive - whether there are price levels

above the competitive price levels in an industry, is the structure of the industry relevant?"

A "Yes."

Q "And is the concentration of the industry relevant?"

A "As an element of structure, yes."

Q "And is the existence of entry barriers relevant?"

A "Entry conditions are relevant."

Q "Are prices above the competitive level more likely to occur in a highly concentrated industry than an unconcentrated industry?"

A "Other things equal, looking at a very large sample of industries and a great disparity in the level of concentration in the two in your hypothetical, yes."

Q "And all other things equal, are above competitive level prices more likely to occur in an industry where high --- "Let me start again." All other things being equal, are above competitive level prices more likely to occur in an industry with high entry barriers than one with low entry barriers?"

A "Yes, for the definition of entry barriers that encompasses only those costs which an entrant must bear, but which an incumbent firm does not have to bear or has not in the past borne."

Q "If you saw an industry that had high concentration and comparatively high accounting rates of return, would the fact [p. 61-220] of the comparatively high

accounting rates of return be an indicator of possible pricing above the competitive level?"

A "Not necessarily."

Q "Would it be a relevant factor?"

A "Yes. It would arouse my curiosity."

Q "What pricing practices would you look for in trying to determine whether there might be prices above competitive levels?"

A "I think it's very difficult for an economist or an accountant or any other objective observer to look at a market in particular and to judge whether prices are above or below the competitive level."

Q "Would you compare accounting rates of return ---"

MR. PECK: Garrett, could I have a page?

MR. RASMUSSEN: Excuse me; I'm on Page 75.

MR. PECK: Thank you, Garrett.

MR. RASMUSSEN: Let me start again.

Q "What pricing practices would you look for in trying to determine whether there might be prices above a competitive level?"

A "I think it's very difficult for an economist or an accountant or any other objective observer to look at a market in particular and to judge whether prices are above or below the competitive level."

Q "Would you compare accounting rates of return in one [p. 61-221] industry with accounting rates of return in another industry, then?"

A "I might do that with extreme care."

Q "What else could you do?"

A "As I said before, you can look at conduct, and you can look at structure."

Q "All right. With respect to conduct, what can you look for? You said pricing practices, but when we poke into that, you said you really can't look into pricing practices because ---"

A "Evidence of overt collusion."

Q "What is evidence of overt collusion?"

A "Transcripts of telephone calls, minutes of meetings."

Q "Can there be prices higher than competitive level prices absent overt collusion?"

A "In what kind of industry?"

Q "In a highly concentrated industry."

A "Probably."

Q "What type of pricing behavior would you look to in that highly concentrated industry to see or to test the hypothesis that there might be pricing above competitive levels?"

A "It is suggestive, if there is a dominant firm, a firm with a market share far above any of its rivals, that happens to lead ---"

MR. LEFELL: Ken, you left out a word.

* * *

[p. 61-223] disciplining or removing rivals and, as an ancillary effect, discouraging new entrants?"

A "Pricing below marginal cost to do ---"

Q "For the purpose of disciplining or removing rivals and, as an ancillary effect, discouraging new entrants?"

A "I think that's a very adequate definition."

Q "Predation doesn't have to result in a competitor leaving the market, does it?"

A "For it to be predation?"

Q "Yes."

A "I would say not."

Q "Predation could be successful if the predator reduced its competitive efforts; isn't that correct?"

A "Say it again, please."

Q "Predation could be successful if the competitor, who is the victim of the predation, reduced its competitive efforts; isn't that correct?"

A "If the victim is a competitor, and if the victim is engaging in competitive behavior, and if the nature of predation is to get the competitor to cease acting in that manner, yes."

Q "Do you agree that any realistic theory of predation recognizes that the predator, as well as his victims ---"

MR. PECK: What page are you on, Garrett?

MR. RASMUSSEN: On Page 95, I'll start again.

* * *

[p. 61-226] Q "No, assuming that B&W, for some reason, believed that it could sell generic cigarettes in such a way as to contain the growth of all generic cigarettes in the long run, would that be an anticompetitive intention?"

A "How do you envision them doing that?"

Q "Assume they can do it, anticompetitive intention. We are talking about intention, not conduct now."

A "I might want to think about this one some more, but it seems to me now that insofar as the sole intention of a firm in entering a line of business like that, is to somehow destroy it, that the intention to do that is anticompetitive."

Q "Excuse me, it's late in the day. Good thing I am not an economist." I mixed up a few questions at that point.

"Assuming that demand was declining in the period 1980 to the end of 1985, costs were stationary and list prices were being increased, would that be suggestive of collusion?"

A "Among the cigarette manufacturers?"

Q "Yes."

A "Price fixing could be an explanation for that."

Q "What about - what else could be an explanation for it?"

A "You have said, have you not, that we are looking at the before excise tax of cigarettes, or is it okay for us to assume that excise taxes are constant?"

Q "Yes, assuming excise taxes are constant."

[p. 61-227] A "I cannot think of an explanation for that hypothetical that accords with the theory of competition. We are assuming that products remain the same as before, no changes in the products."

Q "Yes. Could that behavior reflect price leadership in an oligopolistic market?"

A "That's really two questions. I would infer it's an oligopolistic market just from the fact, the mere facts of the level of concentration and other structural levels."

Q "Would that pricing behavior suggest cooperative pricing among the firms absent an express collusive agreement?"

A "As opposed to there being an explicit collusive agreement?"

Q "Yes"

A "I would think any collusive agreement that is effective, whether explicit or tacit, could produce the scenario you have described."

Q "Assume that Liggett - well, assume that Liggett wrote a document saying that its intention was to dominate the generic category. Would that be anticompetitive?"

A "Once again, the document only goes to the intent of Liggett, and whether Liggett engaged in some

anticompetitive practice is not revealed by the intent recorded in the document."

Q "What if the document said that it was Liggett's intent

* * *

[p. 61-231] Q "But prior to Liggett's introduction of generic cigarettes, prior to 1980, isn't it true that price had seldom been a competitive tool in the cigarette industry?"

A "By which you mean there was not a great deal of active price competition?"

Q "Yes"

A "That's the opinion of economists who have studied the industry carefully, and I am not prepared, having not studied the industry that carefully, myself, to disagree."

Q "If B&W's consortium were truly available to everyone, wouldn't you expect all customers to be in the top volume bracket?"

A "If they were available to everyone, literally, and without any transactions costs, search costs, lack of information about the full availability of those terms and the like, then yes."

Q "Did you see a B&W document that gave any explanation for why B&W promulgated volume rebate schedules?"

A "I do recall testimony to the effect that Brown & Williamson sought to sell to large customers, and I would

infer that the volume breaks were drawn up to give incentives to this category of customers."

Q "Isn't it true that B&W did sell generic cigarettes to different customers at different prices during 1984?"

A "At different net prices?"

[p. 61-232] Q "Yes"

A "That is rebates included. My understanding is yes."

Q "Was another objective trying to brake, b-r-a-k-e, as much as possible, the growth of the generic segment at the same time they were pushing the accelerator to get into the generic segment?"

And Mr. Peck objected to the form of my question.

A "I had difficulty all along with this idea of going both at once. It seems to me that having entered the segment, that is a vote for involvement in the segment, active involvement in the segment, and that it's inconsistent with a notion that they were trying to somehow thwart the sale of generic cigarettes."

Q "Didn't you see some documents that - written by senior B&W executives, that used about - a desire not to or a constraint of not expanding the generic category?"

A "I recall that being raised as a concern at some point. I also recall at least in a couple of places, in documents, one in March and one I believe in May of '84, that that seemed to be - I think I can quote this - no longer tenable. That is, the company was in no position, after R.J. Reynolds repositioned Doral, to compete with

black and white cigarettes, to in any sense control the segment."

Q "Didn't Jan Tharaldson, a B&W employee, also tell you in the fall of 1985 if you could come up with a method by which

* * *

[Excerpt Of The Trial Testimony Of T. Keller]

[p. 62-44] didn't, necessarily, I don't think. At least, their initial offer wasn't. Now maybe there are some documents in there that said before they even made the first offer - I can't recall - they may have said that "We are prepared to spend down to zero variable margin," or something. But this is a little too general.

MR. TOPMAN: Okay, sir.

(End of bench conference.)

BY MR. TOPMAN:

Q Sir, is there a relationship between spending full variable margin or spending variable margin fully on trade discounts and allowances, and pricing below average variable cost?

MR. LONDON: Objection to the form of that question.

A Yes, there is.

THE COURT: Repeat the question. Is there a relationship between - and what was the first word, "full"?

MR. TOPMAN: Spending variable margin on trade discounts and allowances, and pricing below average variable cost.

THE COURT: Spending any amount of variable margin?

MR. TOPMAN: Spending --- Yes.

THE COURT: All right, sir. Overruled. If you can answer - you may answer if you can answer it in that form.

A The answer to the question is yes.

[p. 62-45] BY MR. TOPMAN:

Q Can you tell us what that relationship is?

A Well, if you spend full variable margin on the total of the variable margin, you will not have covered certain variable costs. Therefore, you will, in fact, be selling the product at less than the full variable cost or the average variable cost on a per-unit basis.

Q Okay. And can you give us some examples of variable cost that would not be covered if you spent the variable margin in full on trade discounts and allowances?

A Well, you would not be covering variable overhead. You would not be covering the carrying costs. You would not be covering any selling costs, because there are no selling costs associated with that variable margin.

Q Have you had an exhibit prepared to illustrate and demonstrate your testimony that spending full variable margin on trade discounts and allowances is pricing below average variable cost?

A Yes.

Q I show you Plaintiff's Exhibit 7314, which is a chart you have prepared to assist you, sir, in illustrating that?

A Yes, sir.

Q Would you come up, Dean Keller, if you would, and using PX-7314, explain and illustrate what you've just testified about, sir?

[p. 62-46] A Yes, sir. This is a chart which is labeled, "The effect of spending full variable margin on trade discounts and allowances."

It shows that the variable costs exceed the sales value. And what we have here in this green area is represented by the total revenue derived from the sale of the product. It's labeled, "Sales value," which says this is the total dollars received from customers for the sale of the product during a particular period of time. In fact, we spend a portion of those dollars on the variable manufacturing costs and excise taxes associated with the manufacturing of that product.

We will have what is left, called the variable margin or the full variable margin. That's the remainder of the revenue after deducting from revenue the cost of manufacturing the product and paying the excise tax to the federal government.

At that point in time, we have other variable costs in the form of manufacturing overhead costs that we referred to. And we have carrying costs of the working capital that we have referred to, that must be covered. And, of course, that comes out of, if you will, the variable margin - full variable margin. And that, of course, leaves some additional margin which essentially is available to be used to cover other costs or could be used for discounts and allowances. But at that point these variable

costs are being covered as [p. 62-47] well as the manufacturing costs, and there's some money left over, if you will.

If, in fact, we spend this variable margin in trade discounts and allowances, which essentially is typically thought of as a reduction of the selling price, and we're covering our variable costs, but there's nothing else left over, that's all that we have available to us. If at that point we spend additional money on discounts and allowances, and we, of course, will not be covering certain costs, and the costs - the variable costs we will not be covering are the carrying costs of working capital, because we have increased the trade discounts and allowances. and these are the variable costs in excess of sales value which are not covered.

And then, finally, if we discount the product further with additional trade discounts and allowances, we will also not be covering the variable manufacturing overhead. So if we spend the entire variable margin on trade discounts and allowances, we will, in fact, not be covering these carrying costs or the variable manufacturing costs, at least. So these costs are variable costs in excess of the total sales value, which is the total revenue derived from the sale of our product to our customers.

Q Thank you, Dean Keller.

Now these two items on this illustration, for example, [p. 62-48] would be the amount by which you would be pricing below average variable cost?

A That is correct.

Q Dean Keller, do the B and W planning documents prepared in connection with Brown and Williamson's introduction of generics state that B and W was prepared to spend full variable margin on trade discounts and allowances?

A Yes.

Q Do you have an opinion whether, as an accounting financial matter, this is equivalent to stating that Brown and Williamson is prepared to sell below average variable cost?

MR. LONDON: Object, Your Honor.

THE COURT: Overruled.

A Yes, sir.

BY MR. TOPMAN:

Q Now, sir, I'd like to show you Plaintiff's Exhibit 2, which is in Tab 5. Do you have that, sir?

A Yes, I do.

Q And it's entitled what, sir?

A It's entitled, "Generics presentation," and it's dated February 9, 1984.

Q And would you turn to the page stamped 068425?

A Yes, sir.

Q And what is it headed, sir?

* * *

[p. 64-52] this question first, Your Honor.

MR. FOSTER: That's the reason I want to approach. I object.

THE COURT: Well, what is the objection? I'm going to overrule any objection to the question.

MR. FOSTER: The objection, Your Honor ---

THE COURT: No, sir. I'm going to overrule the objection to the question. Go ahead.

A Sir, I don't know how to answer your question except to say that prices were charged were competitive prices [sic]. They were prices that sold the product in the marketplace, and therefore were market-determined prices.

BY MR. LONDON:

Q Does that mean that they weren't higher than competitive prices?

A They were market-determined prices. And I don't know what the concept of competitive prices is that you have in mind, or I don't have one in mind. So I can't answer the question they were or they were not.

Q Well, sir, you've told us now that you were - you have a degree - you majored in economics in college, and you are in the economics department at Duke; isn't that right? You were an associate professor in the Department of Economics; isn't that right?

A I taught accounting. It was a combined department of [p. 64-53] accounting, economics, and business administration.

Q And is it your --- Well, let me ask another question. Was the company of which you were a director making higher than competitive profits on its branded products while you were there?

MR. FOSTER: Objection, Your Honor. That's what he just said he can't answer.

THE COURT: Well, if you can answer, you may. You say you don't know?

THE WITNESS: I don't know.

BY MR. LONDON:

Q Well, did you -- as a director and as somebody who is aware, you knew, did you not, that Liggett was charging pretty much the same for its cigarette products as were its competitors? You knew that?

MR. TOPMAN: Objection. Beyond the scope. It's fact testimony.

THE COURT: Overruled.

A I don't know what the competitors or Liggett was charging. I know what the list price to the customer was in the store, but I determined that as a consumer, not as a director.

BY MR. LONDON:

Q Were you aware in 1978, '79, and '80 of any information that Liggett was tacitly coordinating its list prices with [p. 64-54] another company?

A No, sir.

MR. TOPMAN: Your Honor, I would like a continuing objection to this line.

THE COURT: Yes, sir. Go ahead.

BY MR. LONDON:

Q Were you aware of any information that Liggett was engaged in any sort of tacit, unspoken or unstated, understanding of any kind with the other tobacco companies respecting the prices of its products?

A If it was unstated or unspoken of any kind, I wouldn't have any way to know it, sir. So, no, I didn't know anything about it.

Q Is it fair to say, sir, that while you sat on the board of directors of Liggett and Myers ---

MR. TOPMAN: Objection.

THE COURT: To what?

MR. TOPMAN: The question, Your Honor.

THE COURT: Well, he hasn't finished it.

MR. TOPMAN: Well, he said he was director of Liggett and Myers. The testimony is directly to the contrary.

THE COURT: Liggett Group.

BY MR. LONDON:

Q When you were on the board of Liggett --- Withdrawn. I

* * *

[Excerpt Of The Trial Testimony Of L. Butler]

[p. 69-178] Q All right, sir. Let me ask you to look at the attachment to that letter for me, please, sir.

Does it say here, sir, as a part of that attachment, "Ask B&W for a two year guarantee on their hot-shot deals. Wouldn't you get some strange answers"?

A That's what it says, yes, sir.

Q All right, sir. And is that letter dated prior to the time that you guaranteed your rebates for a year, sir?

A Yes, sir.

Q Did you receive word from the field, sir, that those types of comments were being made to your customers?

A That was one of the largest problems that we were having at the time was whether or how long we would be in it, the questions that had been raised with our customers as to what our commitment was.

Q Mr. Butler, after your final offer on July 17, 1984, did Liggett thereafter increase its offer?

A Yes, sir.

Q How much did they increase it by, sir?

A It was another round of five cents a carton.

Q Did Brown and Williamson respond to that increase?

A No, sir.

Q Why not, sir?

A Well, the same reason we didn't respond. We couldn't. That was it. I couldn't. I didn't have the authority to do . . .

* * *

[p. 70-101] Q Is that correct?

A Yes, sir.

Q All right, sir. And when Brown and Williamson was selling generic cigarettes in 1984, is it consistent with your recollection that generic cigarettes were being sold by 90 percent of its wholesalers?

A Yes, sir.

Q Mr. Butler, did you have any private label business in 1984?

A No, sir. Not in '84. No, sir.

Q Were consumers paying less or more for generic cigarettes after Brown and Williamson started selling them in 1984?

A They were paying less.

Q Why, sir?

A They were getting retail promotions that they had never gotten before. They had dollar stickers off on generic cigarettes. A lot of the rebates that were being paid were passed on through to consumers. They were paying less money.

Q Let me turn our attention now to 1985, please. To your knowledge, did Liggett's efforts to keep Brown and Williamson from selling generic cigarettes continue in 1985?

A Yes, sir.

MR. FOSTER: Objection, Your Honor, to the form of the question.

* * *

[p. 70-104] letterhead?

A Yes, sir. It is.

Q And what's the date of the document?

A May 23, 1985.

Q All right, sir. Does it indicate, sir, in the third paragraph, "In May of 1985 our generic products still have 82 to 85 percent of the total generic business and has a 5 percent share of market nationally"?

A Yes, sir.

Q All right, sir. And let me ask you to look at Defendant's Exhibit 3726. All right, sir. And what's the date of this document?

A June 7, 1985.

Q All right, sir. Is it a Liggett or a Brown and Williamson document?

A It's Liggett.

Q And is it again on Mr. Parham's stationery?

A Yes, sir. It is.

Q All right, sir. And does it indicate - it's to Eli Witt? Is that correct?

A That's correct.

Q The company that Mr. Skip Eads worked for.

A Yes, sir.

Q All right, sir. Does it indicate, sir, in the second paragraph, "As we discussed, our company's market share [p. 70-105] continues to grow nationally over our competition, Brown and Williamson and R.J. Reynolds' Doral generic cigarettes"?

Does it says that, sir?

A Yes, sir. Yes, sir.

Q Does it also indicate, sir, "also, as we discussed, for every generic you sell, your gross profit is more than in Winston, Marlboro, et cetera. Do not cannibalize your generic business that you have built up by Doral and B & W sales"?

A Yes, sir. That's what it says.

Q Mr. Butler, how much success did Brown and Williamson have during the first part of 1985?

A It was very limited the first part - of the first quarter, the first part of 1985. It was very, very limited.

Q All right, sir. To your knowledge, did Liggett take any competitive action against Brown and Williamson in the first part of 1985?

A Sure. Yes, sir.

Q What, to your knowledge, did they do, sir?

A The same competitive action that we had had in the past. There was disparagement [sic] of the products, there was still the lawsuit, there was still the same actions as we had in the past that we've talked about.

Q Mr. Butler, with respect to the customers, the larger customers you had been successful [sic] in gaining distribution

* * *

[p. 71-129] the price of full revenue cigarettes?

A No, sir.

Q Is there anything B & W did in offering rebates that slowed the growth of the value-for-money segment?

MR. TOPMAN: Objection. Leading.

THE COURT: Overruled.

A No, sir.

BY MR. MICHAEL ROBINSON:

Q Did B & W do anything, sir, which increased the growth of the value-for-money cigarette?

A Yes. Yes. They did.

Q What did you do, sir?

A Created a lot of competition in the marketplace with the distributors, had a lot of retail promotions on the product, offered the private consumer a better price, had competition as far as rack space, as far as product availability, as far as featuring the value-for-money cigarette brand; helped stimulate the category.

Q Mr. Butler, we've heard the terms "growth" and "rate of growth" when referring to value-for-money cigarettes, sir. Is there a difference in the definition of those terms?

A Yes, sir.

Q Well, sir, could you give us a practical application of the difference of the meaning of those terms, growth and rate of growth?

[p. 71-130] A Well, the growth is how many cigarettes that it grows, by how many cigarettes. And the rate of growth would be the percentage in which it grows.

Q Let me ask you to do -- and I tremble when I ask -- but let me ask you to do a little math with me, please, sir.

If you have a market, sir, a segment of the market that in 1984 sells 100 cigarettes ---

A Yes, sir.

Q --- and in 1985 sells 200 cigarettes ---

A Yes, sir.

Q --- what is the growth of that segment?

A That's 100 percent.

Q All right, sir.

A I passed.

Q And what is the growth in terms of the number of cigarettes?

A 100.

Q Sir, if in 1986 you sell 300 cigarettes, what is the growth in terms of the number of cigarettes?

A 100.

Q The same as for 1984 to 1985?

Q The same as for 1984 to 1985?

A Yes.

Q What's the rate of growth, sir?

A Fifty percent.

Q The number of cigarettes increased is the same, but the [p. 71-131] rate goes down?

A That's correct.

Q How's that, sir?

A Well, your base gets larger. When your base gets larger and you increase by the same number of cigarettes, your percentage goes down.

Q Mr. Butler, in your experience since 1958 in the cigarette industry, have you seen any segment, sir, where the rate of growth has decreased over time?

A Oh, ever single one of them. As they begin to grow and as they begin to get larger and larger, the rate of growth naturally goes down.

Q How did the rate of growth of generics in 1985 compare with the rate of growth of generics in 1984?

A Well, it was less.

Q Did you expect that to happen, sir?

A Yes, sir.

Q Let me ask you to look at the last exhibit, sir, the first one we looked at last Tuesday. Would you look at Defendant's Exhibit 2705 with me, please. And again, sir, I believe this is the letter from Mr. K. v. Dey to Mr. J. W. Old.

A Yes.

Q All right, sir. Let me ask you, if you would, please, sir, to turn over - if I can find it, sir - to Page 2 of that [p. 71-132] document.

Let me ask you, sir, if it says under "Environment," "The major trend in the industry continues to be the growth [sic] of the low-tar segment, 15 milligrams and below"?

A That's correct.

Q Does it say down here, sir, "We anticipate the low-tar trend to continue, however, at a decreasing rate"?

A Yes, sir.

Q Are there any segments, sir, in your experience since 1958 where the rate of growth has not decreased?

A Absolutely none.

Q Does this mean, sir, that growth stopped?

A Not at all, sir.

Q Mr. Butler, did Brown and Williamson do anything with the intent to injure competition?

A Absolutely not, sir.

Q In your opinion, sir, has competition been injured?

A No. It has not. It has been increased.

MR. MICHAEL ROBINSON: That's all sir. Thank you. If you'll answer Mr. Foster's questions.

THE COURT: All right. Ladies and gentlemen of the jury, we're going to take a recess.

It's now a quarter to 1:00. I'm going to give you until 2:15. We'll take up a couple of matters in your absence. And please remember to keep an open mind on the

* * *

[p. 75-35] [A] . . . talking about percentages. The category was growing, and grew every month. It grew every month since we got in it. But any time you get into a business and any time the base gets larger, that rate of growth is going to slow. It's not going to continue growing at the same percentage rate, because with every month that goes by, with every new customer that comes in, competitor that comes in, and as this segment expands, that rate of growth is going to slow down, of course, the percentage rate. But the growth is still there.

Q And this document indicates, does it not, that your anticipation was that that rate of growth would slow after you entered the market?

A Because the segment got larger, of course. If we got in it and we expanded the base, of course, the rate of growth is going to slow, because the segment gets larger.

Q Okay, sir. Now it also says that if the GPC agreement gave you one-third of the overall generic-priced cigarette market, you would be in a more competitive market position. That was viewed as a benefit to this agreement, right?

A Well, if we're talking about one-third of the business, any time you're --- We wanted to sell all we could, and sure, you'd be in a competitive situation.

Q Isn't that because it would put you in a position of price leadership?

* * *

[p. 77-103] sir?

A Yes, sir.

Q And up here at the top it says, "B & W's presence within the segment appears to have resulted in reduced consumer advertising by L & M and a slowing in the segment's growth rate."

Is that correct?

A That's what it says. And yes, sir, that's a slowing of the growth rate. And as we talked about, Mr. Foster, as the base gets larger, as that segment gets larger, then the percentage or the increase -- the rate of growth is naturally going to slow.

Q Well, that's exactly the same sentence as was contained in the document from Ms. Olges to Mr. Sandefur. Is that not correct, sir?

A That looks like it. Yes.

Q And it is a fact, is it not, sir, that B & W considered that the reduction in consumer advertising by Liggett and Myers was an aspect of Brown and Williamson's pricing strategy?

Is that not correct, sir?

A Well, sir, you're asking me to interpret the fact that Liggett and Myers had spend a lot of money in rebates against Brown and Williamson.

And if that was money that they were spending in

. . .

[p. 77-153] A Yes, they have.

Q Well, sir, I want to go over what the prices are today for cigarettes, if I might.

A Okay.

Q Let me ask you first, sir about Liggett and Myers.

A Okay.

Q And I want to make it, sir - on this board - full revenue first, sir.

A Okay.

Q Okay?

A Okay.

Q And would you tell me, please, sir, what Liggett is charging today per thousand for kingsize, full revenue cigarettes?

A Forty-eight sixty-five a thousand.

Q All right, sir. All right, sir. I want to ask you next about Philip Morris. I always do that wrong. It's one "P" - I mean one "L". Philip Morris. How much are they charging per thousand for full revenue kingsize cigarettes?

A Forty-eight sixty-five a thousand.

Q All right, sir. Now, sir, there's a method in my madness, I promise you, but I want to ask you about

American. Do you know how much they are charging for hundred millimeter cigarettes, full revenue?

A Forty-seven sixty-five.

[p. 77-154] Q All right, sir. And, finally, sir, R.J. Reynolds. How much are they charging for kingsize, full revenue cigarettes?

A Forty-eight sixty-five.

Q All right, sir. And so the record will be clear, I'm going to put on this board under "American," "100's" and for Liggett, Philip Morris, and R. J. Reynolds I'm going to put "KS" for kingsize.

A Okay.

Q All right, sir?

A Okay.

Q Now I want to ask you first about R. J. Reynolds. How much are they charging for their best-value black and white cigarettes?

A Nineteen seventy-five.

Q All right, sir. All right. And if you do the math with me, I believe, sir, that's 28.90. Does that sound right?

A Twenty-eight ninety. Right.

Q All right. Now let me ask you about American. Do they make a brand called Montclair?

A Yes, they do.

Q What is Montclair, sir?

A Montclair is a regular, full trade dress cigarette that is made only in hundred millimeter brand - styles.

Q They don't make a kingsize?

A No, not now.

[p. 77-155] Q Let me show you Defendant's Exhibits 8044, 8045 and 8046 and ask you if you can identify those, sir.

A Yes. These are the three brands that - three styles that they have in the Montclair brand.

Q To your knowledge, were they making that cigarette as a value-for-money product when this trial started?

A No, sir.

Q All right, sir.

A Well, I'm not sure whether they were or not, Mr. Robinson. I can't even remember when the trial started, but it's a new brand.

Q All right, sir. Well, let me ask you, how much are they getting for Montclair hundreds?

A Twenty-three dollars a thousand.

Q All right, sir. And that's one of the few ones that may be easy, and I'm sure I'll mess it up now. Is the difference between those two figures forty-seven sixty-five and \$23.00, is that \$24.65?

A Twenty-four sixty-five. That's right.

Q All right, sir. All right, sir. Philip Morris. Are you familiar with a brand called Bristol?

A Yes.

Q When did Philip Morris start selling Bristol, sir?

A That was this year.

Q All right, sir. Let me ask you to look at Defendant's [p. 77-156] Exhibits 8070, 8071 and 8072, and can you tell me what those are, please, sir?

A That's the three styles that they have in Bristol.

Q All right, sir. Do you know how much Philip Morris is charging for Bristol, sir?

A Twenty-one seventy-five.

Q All right, sir. All right, sir. And I believe the difference between those two is \$26.90. Is that correct?

A That's right.

Q All right, sir. Now, finally, I want to ask you about Liggett and Myers, and I want to show you first Defendant's Exhibits 10,570 and 573, 10,044 and 10,034. Can you tell me what those are, sir?

A Yes. That's Liggett and Myers' Pyramid brand.

Q All right, sir. Now to your knowledge, is Liggett selling private label cigarettes at the same price they're selling Pyramid?

A Yes, they are. Some of these.

Q How much does Liggett charge for Pyramid?

A Twenty-three dollars a thousand.

Q All right, sir. And what would that gap be? \$25.65?

A Let me use my trusty-dusty --- Yes.

Q All right, sir. Let me ask you, if you can please, sir, to tell me, what the percentage spread is between Liggett's full-revenue brand and their lowest priced private [p. 77-157] label.

A It's 52.7.

Q Percent?

A Percent.

Q All right, sir.

How about Philip Morris, between its full-revenue and its Bristol brand?

A Okay. 55.2.

Q All right, sir. And American, between Montclair and its full-revenue.

A That would be the same as Liggett and Myers. I believe that's right, isn't it?

Q Well, try it just to make sure.

A Oh, I'm sorry. No, no, no, no. Philip Morris?

Q American, sir.

A Oh, American. Okay. That would be 51.7.

Q Fifty ---

A 51.7

Q Percent?

A Percent.

Q All right, sir.

And, finally, R.J. Reynolds.

A Okay.

Q Between its full revenue and its private label - I mean generic. Best-buy.

[p. 77-158] A Is that twenty-eight ninety?

Q It's twenty-eight ninety, yes, sir.

A That's 59.4 percent.

MR. MICHAEL ROBINSON: For the record, Your Honor, I'm marking this board Defendant's Exhibit 8250.

(The board above referred
(to was marked for
(identification as:

(DEFENDANT'S EXHIBIT
(NO. 8250.

MR. MICHAEL ROBINSON: And, Your Honor, at this time we would move the introduction of Defendant's Exhibits 10,034, 10,044, 10,570 and 573. Defendant's Exhibits 8044, 8045, 8046, and Defendant's Exhibits 8070, 71, and 72.

THE COURT: They are the Montclair, Bristol and Pyramid packs?

MR. MICHAEL ROBINSON: Yes, sir.

THE COURT: All right. Admitted.

(The items above referred
(to were received into
(evidence as:

(DEFENDANT'S EXHIBIT
(NOS. 10,034, 10,044,
10,570, 10,573, 8044,
8045, 8046, 8070, 8071,
and 8072.

MR. BARKER: Your Honor, may we approach a moment?

THE COURT: Yes.

* * *

[p. 77-176] A Yes.

Q Do you know, sir, why key accounts – that term that's used by Mr. Van Scotter – had an objection to the quality of Brown and Williamson's product?

A Yes. They were told the quality was inferior to the GPC that they had had when it was manufactured by Liggett and Myers.

Q Told by who, sir?

A By Liggett and Myers' people.

Q Mr. Butler, I believe Mr. Foster questioned you on the issue of whether rebates were passed on. Do you remember that, sir?

A Yes, sir.

Q Now did wholesalers pass on rebates?

A Oh, yes, sir.

Q Why did they do that, sir?

A They passed on rebates so they could be more competitive against their competition, so they could give the retail – the retailer a lower price.

Q Let me show you Plaintiff's Exhibit 3087, which is already in evidence, sir. Now I believe Mr. Foster showed this to you and asked you about a portion of the document, and I want to refer you to another portion, please, sir.

And do you recall him indicating to you that this was a memo written by Mr. K. v. Dey?

* * *

[Excerpt Of The Trial Testimony Of H. Higgins]

[p. 89-51] say, "Yes, I believe they were ---"

MR. BARKER: Fine.

THE COURT: "--- based on information I received."

Okay. Let's go.

(End of bench conference.)

BY MR. PECK:

Q Let me just step back a minute, Mr. Higgins. In your opinion, did direct customers pass on to their retail customers the rebates they received in whole or in part from Brown and Williamson and Liggett?

A Many customers passed on either all or part of the rebate, yes, sir.

Q And what is the basis for your opinion?

A The knowledge that I have, sir, from direct discussion with the customers, the visible evidence that I have from seeing it printed in order books.

Q Can you explain what you mean by the visible printing of it in order books, sir?

A Well, the best example on that, sir, would be Southland Corporation, SDC Center, Southland Distribution Centers, which is the arm that services the -excuse me- 7-11 stores, and they also service outside customers. They're actually owned by 7-11, and they service outside customers. They gave 25 cents a carton of their rebate back to the customer for buying generics.

[p. 89-52] Another situation is Grocer Supply in Sulphur Springs, Texas. What they did was - the only place I saw this, very unusual - but they took their generic rebate and they rebated a discount on all cigarette purchases based on the monies that they received from generics. And that was given to me directly by the buyer merchandiser at Grocer Supply telling me how they were doing that.

Other situations was with - one second here.

THE COURT: Well, go ahead, Mr. Peck.

A Barry Barnett.

BY MR. PECK:

Q What was Barry Barnett?

A Barry Barnett, and I had Texas Wholesale Grocer. They discounted, and they did it off of invoice.

Q Okay. You've mentioned, sir, quarterly rebates, rebates off the invoice, and lowering the price of all cigarettes. Were there other methods used by certain customers to pass on all or some of their rebates to their retail customers?

A Yes, sir. There was another situation that I'm very aware of in Forrest City, Arkansas; Forrest City Wholesale Grocery Company ---

Q And what did they do?

A --- where they discounted other non-cigarette related items, candy, and they would lower the price on their candy actually below cost as a inducement for the

person to buy [p. 89-53] cigarettes from them. And they used the rebate monies off generics to do that.

Q Now are you familiar with J. M. Jones Company?

A J. M. Jones is a division of Super-Value.

Q To your knowledge, were they passing on any or all of their rebates?

A They were passing on rebates, yes, sir.

Q Let me show you, sir, Defendant's Exhibit 832. Sir, without going into the substance of this document, I want to get some background information about it. Can you tell me whether you received a copy of it, sir?

A Yes, sir.

Q And is it from Sharon Smith?

A That's correct, sir.

Q And what type of document is this?

A This is an executive summary, sir, of senior field manager reports that she would compile at the corporate office, and for the purpose of sending it up to the senior management, executive management, and then I also received a copy.

Q And how often, to your knowledge, was this type of report prepared by Ms. Smith?

A They were done at least monthly.

Q And was it prepared by her in the regular course of her business, to your knowledge?

* * *

[p. 89-58] Q Now, sir, in your opinion, how can wholesalers pass on all or part of their rebates when they don't know what volume bracket they're going to fall into for the quarter until the end of the quarter?

A Well, they pretty well knew how much business that they were going to do. And at the worse case scenario, they knew that they would get the lowest bracket. So most of them did not pass on all of the rebates. They passed on a portion thereof. So if they passed on a portion that did not exceed their guaranteed rebate, then they weren't taking a risk of losing money.

Q Now you also mentioned, sir, that some of your customers were passing on their rebates up front, off invoice?

A Yes.

Q They were not getting --- Isn't it true, sir, that they were not getting paid the rebates from Liggett or Brown and Williamson, as the case may be, until the end of a quarter?

A That's correct.

Q Now in your opinion, sir, how could a wholesaler pass their rebates on, up front, off invoice, when they weren't getting paid that money from Liggett or Brown and Williamson until the end of the quarter?

A Well, I would view that just the same way that I view the credit terms that they give. They have to pay us, the manufacturers, on average in 14 days. Our terms are 14 days. [p. 89-59] But many distributors give 30-day terms to their retailers, so it's simply the cost of doing

business. And so if they pass these on in advance, I see that, sir, as just a cost of doing business.

Q In your opinion, sir, do wholesalers charge the same price to all of their retail customers for generic cigarettes?

A No, wholesalers don't charge the same price consistently to all customers, sir, on any of the cigarettes. Many of them have volume breaks. The higher volume a customer does --- Sometimes it's even combined with groceries. But the higher volume they do, the lower the price is, in most cases.

Q Sir, I want to turn to a different subject. When you spoke to customers in the summer of 1984, did you ever find that a customer was receiving a rebate from Liggett greater than that customer's volume would have warranted under the volume rebate published offer?

MR. FOSTER: Objection. Pure hearsay.

THE COURT: Sustained to the form.

BY MR. PECK:

Q Did you have discussions with customers as to the amounts of rebates they were getting from Liggett, sir?

MR. FOSTER: Objection

A Yes, I did.

* * *

[Excerpt Of The Trial Testimony Of B. Bacon]

[p. 93-52] to 1988 of the schedule, correct?

A Based upon Brown and Williamson's assumed full-priced product, we held the gap at 35 percent, yes, sir.

Q All right, sir. I want to change subjects now, sir. Did the Brown and Williamson hierarchy approve the proposal that was set forth in the document we were just looking at, PX-4146, also called the final proposal, dated May 15, 1985?

A "Hierarchy" meaning outside of Brown and Williamson?

Q Yes. Somebody north of whomever.

A No, sir, they did not.

Q Why not?

A Two factors. One is, is that the proposal included also the launch of Hallmark, and that was not approved. And secondly is that we were told to deliver a profit which was quantified - a trading profit, which was later quantified or was quantified as \$1.00 per thousand cigarettes. That was by BATUS, more specifically Charlie McCarty, and has been known as "Charlie's dollar."

Q Now, sir, I show you a copy of what has been marked as Defendant's Exhibit 363. It's a document dated 5/22/84.

A It is, sir.

Q A Brown and Williamson document ---

A Yes, it is.

Q --- relating to the black and white launch?

A Correct, sir.

* * *

[p. 93-88] MR. TOPMAN: Objection.

MR. HOGELAND: Objection.

MR. BARKER: Objection.

MR. FOSTER: Objection.

THE COURT: All right. Well, the jury will remember whatever Mr. Burnett testified to. Go ahead. Ask the question.

BY MR. LONDON:

Q Just so we have the record complete, if you would, turn please to the cover page of Exhibit 8002.

A Yes, sir.

MR. LONDON: I'm going to show this on the screen, Your Honor, because it's also part of the exhibit. I'll make a single exhibit to show the cover page and those two pages and give it to Ms. Vaughan.

THE COURT: Is that your handwriting?

THE WITNESS: Yes, sir. It is.

BY MR. LONDON:

Q And are those your initials over there? B.E.B.?

A Yes, sir. They are.

Q And a copy given to E.P.T.? That's Tucker, Eckmann and Wilson?

A That's correct, sir.

Q Over on the right-hand side?

A Yes, sir.

[p. 93-89] Q And is that your handwriting?

A Yes, sir. It is.

Q Okay. Thank you, sir. And the date in the upper left-hand corner, it says, "Revised 5/23/84."

A Yes, sir.

Q Is that your handwriting?

A Yes, sir.

Q Thank you, sir.

Now I want to change subjects so we can put that - you can put that document down for a minute.

Now, Mr. Bacon, aside from any earlier visits, which I think have been referred to as selling calls or whatever, when did Brown and Williamson announce to the trade that it would begin selling generics?

A It was on or around June 4, I believe, sir.

Q And did Brown and Williamson announce in that connection ---

A Excuse me. 1984.

Q And did Brown and Williamson announce in that connection a program of allowances, a rebate?

A Yes, sir.

Q And I want to show you what has earlier been marked in evidence as Defendant's 604A. I'm sorry. It's not in evidence. I'll hand it out.

Looking down to the paragraph in the middle of the page [p. 93-90] - of the front of the page of 604A where it says "B & W, June 4, 1984." And it has a range of rebates beginning with zero in the zip to 99 cateogry [sic], and 30 cents in the 1500 plus category. Is that right?

A That is correct, sir.

Q Now how did these allowances as announced on the June 4 first rebate schedule compare with the allowances that you put into your financial schedules in connection with the final proposal?

A If you'll recall, in the financial schedules we had a trade allowance amount of a dollar sixty-five per thousand which we translated to 33 cents a carton.

And we had - seven cents of that 33 cents was for fixtures, leaving a rebate amount included in the proposal of 26 cents a carton.

Q Let me see if I can get that straight. I'm writing those numbers on board eighty-six, eighty-six.

(The document above
(referred to was marked
(for identification as:
(DEFENDANT'S EXHIBIT
(NO. 8686.

BY MR. LONDON:

Q The financial schedules - the May financial schedules showed a dollar sixty-five a thousand.

A That is correct, sir.

[p. 93-91] Q And a dollar sixty-five a thousand is how much a carton?

A Thirty-three cents a carton. If you divide a dollar sixty-five by five ---

Q And a carton you said again ---

A Thirty-three cents.

Q Thirty-three cents. Now, sir, I ask you how that 33 cents compared with the Brown and Williamson announcement of June 4 about zip to 30, and you started to say something about fixtures.

A I said there was an amount included in that 33 for fixtures, which was seven cents a carton.

Q As noted in the memorandum that we just read into evidence a few moments ago?

A Right. My memorandum of May 24. Yes.

Q Indicating that in the dollar sixty-five was what?

A Seven cents a carton for fixtures or 35 cents of the dollar sixty-five per thousand for fixtures.

THE COURT: Well, what does that mean? Free fixtures?

THE WITNESS: Yes, sir. Yes, sir.

BY MR. LONDON:

Q So that 35 cents a thousand is seven cents a carton for fixtures?

A That is correct, sir.

[p. 93-92] Q So that the rebate in the trade allowance in the May financial was what?

A Twenty-six cents a carton.

Q Okay. It's written on Board 8686.

Now, sir, if all of your customers -- all of your customers on June 30 --- I'm sorry.

If all of your customers on June 4 came in and bought at the 30-cent level, if that happened ---

A Right, sir.

Q --- you'd be paying more trade allowances than you anticipated in your financials. Is that right?

A That is correct, sir.

Q Because you anticipated in your financials that you were going to give the customer 26 cents. Is that right?

A That is correct.

Q And you anticipated that you were also going to give to the trade seven cents worth of fixtures ---

A That is correct.

Q --- per carton. Is that right?

A That is correct.

Q So your -- in the financials your total projection for what you were going to spend was 33 cents a carton or a dollar sixty-five a thousand?

A That is correct.

Q But of that 33 cents you understood the customer would [p. 93-93] get but 26 of them in money?

A That's correct.

Q And the other seven would be put in fixture expense. Is that correct [sic], sir?

A That is correct, sir.

THE COURT: Well, now in the June 4 proposal or pricing summary the rebate is up to 30 cents or is up to a maximum of 30 cents?

THE WITNESS: Right, sir.

THE COURT: Well, I don't guess you'll finish with it. Maybe there's something about --- Is there anything about fixtures in this?

Well, you go ahead and ask the questions. I was going to ask him if there was any fixture provision. But you go ahead.

MR. LONDON: All right, sir. I'll --- Okay. I'm going to do that.

BY MR. LONDON:

Q Now let me do it this way, sir. I'll rely on the board. I'm going to write these numbers down. See? I'm improving the art now. I'm putting up a board, sir, that's just got some lines on it to try to keep my numbers in the boxes. And I marked the Board 8681.

[p. 93-94]

(The board above
(referred to was marked
(for identification as:

DEFENDANT'S EXHIBIT
(NO. 8681.

BY MR. LONDON:

Q I'm going to put in this first column here the May 1984 final projection. That's the one that's attached to the final proposal. Do you understand that, sir?

A Yes, sir. I do.

Q Now the total allowance in that schedule - the total allowance was, I think you have told us ---

A It's the chart behind there.

Q A dollar sixty-five or 33 cents. Is that right?

A That is correct, sir.

MR. TOPMAN: Objection.

THE COURT: Overruled.

BY MR. LONDON:

Q And then you have told us that included in that 33 cents, as indicated in your memo, you were counting seven cents worth of fixtures.

A That is correct.

THE COURT: Okay. We've got all that. Let's go ahead.

MR. LONDON: All right.

BY MR. LONDON:

[p. 93-95] Q And so the rebate in that May financial was how much?

A Twenty-six cents.

THE COURT: It still comes out - seven - thirty-three minus seven is still twenty-six, isn't it?

THE WITNESS: There's no mystery to this.

THE COURT: Okay. Let's move on.

MR. LONDON: Yes, sir.

BY MR. LONDON:

Q If you go to that financial schedule, you had a trading profit of what?

A Two dollars and thirty-five cents a thousand or 47 cents a carton.

Q Per thousand it was how much, sir?

A Two dollars and thirty-five cents, sir.

MR. TOPMAN: Your Honor, I object to the characterization of the document that way. I don't believe that's what the line says.

THE COURT: I'm sorry. I can't hear anything you're saying.

MR. TOPMAN: Sorry, Your Honor. I object to the characterization of that line item of the exhibit. It's a much more fuller statement, sir, in terms of reserves for trading allowances on the chart.

THE COURT: Well, the jury has got it in front of them.

[p. 93-96] BY MR. LONDON:

Q That comes out to a carton of what, sir? How much a carton?

A Forty-seven cents, sir.

Q And the volume projected on that May proposal was what?

A Two point two billion units.

Q And if you made 47 cents a carton and you sold 2.2 billion sticks, your trading profit would be what?

A Five point two million dollars.

Q Five point two million?

A Yes, sir.

Q Okay, sir. Now I want to go to ---

MR. LONDON: Put up 604A again, please, David.

BY MR. LONDON:

Q --- the first offer -- the 604A offer. Was it --- The offer dealt only in rebates. Right?

A That's correct, sir.

Q And what was -- this was the offer of 0 to 30 cents. Is that right?

A That is correct, sir.

Q Now have you made a calculation as to what the weighted offer was in terms of Brown and Williamson's customers, what they got?

A Yes, sir. I've done the arithmetic.

Q And what does it come out to?

* * *

[p. 93-106] trading profit level or any other level.

[MR. LONDON]: . . . The fact that they didn't do this particular analysis back then -- they didn't do Mr. Burnett's analysis either, but they're going to ask the jury to measure B & W's plans and performance against ---

THE COURT: I don't see how it adds anything to intent though, and that's what seems to be what we are talking about here.

The only point of below average cost pricing is to make an inference of predatory intent, and what does this add to that? I mean, it doesn't even help you to do it now. I mean, you're zero to 30. Nobody's contending that that's below cost, not even Burnett.

MR. LONDON: The problem is not in the first column, your honor. The first column is a hanger. Everybody agrees on the first column, even Burnett. That's right. It's the subsequent columns where people disagree.

Now I agree with Your Honor that the issue is what was Brown and Williamson's intent. Because we don't have absolute clear markers for intent, we've all come to utilize -- rightly or wrongly -- the law recognizes that we take an event, and we draw inferences from it.

We draw inferences forward, and we draw inferences backward.

The whole purpose of Burnett's testimony - his total recalculation of the books and records of the Brown and

* * *

[p. 95-134] A Yes, sir, I did.

MR. TOPMAN: Your Honor, I object to the testimony about unidentified price changes, promotions in an entire six-month period of the year without some specificity - or eighteen months. I'm sorry.

THE COURT: Well, I think he can testify as to what his views were that he solicited. But when you do it, tell us more. Did it happen every time there was a rebate change or generally, or ---

BY MR. LONDON:

Q Answer the Judge's question. Did it happen every time there was a rebate change?

A Yes, sir. But let me qualify that.

Q Yes, sir.

A To the extent that I said we were talking about the period '84 - Mr. Topman said for the whole eighteen months - but I said '84 as it relates to involved [sic] on all of those changes, yes, sir.

Q All right. And did you communicate to the people with whom you were speaking, the Sandefurs and the Butlers and whomever you were dealing with, your views about how the proposed change would affect profitability?

MR. HOGELAND: Objection, Your Honor, if he can't be concrete about who he's communicating to, guys like Sandefur and Butler.

[p. 93-135] THE COURT: Who did you communicate your views to?

THE WITNESS: Mr. Sandefur, to assure him that we were always - the actions being proposed, that we were going to show - deliver a profit.

BY MR. LONDON:

Q Is that what you told him?

A Yes, sir.

Q Each time that you guys discussed a proposed change in the rebates or promotions?

A Yes, sir.

MR. TOPMAN: Same objection, Your Honor.

THE COURT: Overruled.

BY MR. LONDON:

Q Did you expect to make a profit on Brown and Williamson's generics in '84 and '85?

A Yes, sir.

Q Did you make a profit?

A Yes, sir.

Q In '84?

A Yes, sir.

Q In '85?

A Yes, sir.

Q In '86?

A Yes, sir.

MR. LONDON: I have no more questions.

* * *

[p. 95-137] Q And you prepared what we've come to call as the Bacon spread sheet.

A Yes, sir.

Q And a Mr. Brumleve helped you prepare the Bacon spread sheet.

A He sure did.

Q So the Bacon-Brumleve spread sheet tells us - what you calculated in 1984 and 1985 - whether Brown and Williamson made money on generics. Right?

A Yes, sir.

Q And is it true, sir, that Brown and Williamson's careful monitoring by you and Mr. Brumleve shows that Brown and Williamson lost \$383,000 in 1984 on generics?

A That's what it shows at the trading profit line, yes, sir.

Q Let me ask you a question about that while we're here. Mr. London just put up something here and asked you about it, for 1984. He asked about July shipments of 18,000 cases, and he asked you what the trading profit was on those 18,000 cases, and you told him zero. Is that right?

A I told him we had a negative trading profit for the months of July and August because of the monies we spent for retail promotion. I believe that's what my testimony was, sir, yes, sir.

Q So he wrote down zero, and that's not right?

[p. 95-138] MR. LONDON: Objection.

A It was ---

THE COURT: Well, it's less than zero.

THE WITNESS: That's right. That was my testimony.

BY MR. TOPMAN:

Q And the way you write less than zero trading profit is you put a number down there with a parenthetical. Right?

MR. LONDON: Your Honor, I object. If he wants to argue because I put in the profit column a zero, what's he taking it up with Bacon for?

THE COURT: Okay. If you're going to ask him what the loss was for those two months, you may do so. Otherwise let's go ahead.

MR. TOPMAN: Yes, sir.

BY MR. TOPMAN:

Q And instead of having a zero trading profit, Mr. Bacon, there was a loss in June, wasn't there?

A Yes, sir. We had some spending in June and we didn't start selling any cigarettes.

Q And you had a loss in July?

A Yes, sir. That's what I was making reference to.

Q Now the Bacon-Brumleve spread sheet for '85 ---

A Yes, sir.

Q --- that also shows a loss to Brown and Williamson on generics, doesn't it?

[p. 95-139] A It shows a loss at the trading profit line, yes, of \$750,000, which I have testified to, yes, sir.

Q So Brown and Williamson, according to its own careful monitoring, concluded that it lost three-quarters of a million dollars on generics in 1985, right, sir?

A At the trading profit line, that's what it says. When you consider all the benefits, no, we don't feel we lost any money at all.

Q At the trading profit line you lost three-quarters of a million dollars, right, sir?

A At this theoretical trading profit line, that is correct, sir.

Q Theoretical?

A I think I used that term when I described that, yes, sir.

Q Do you define trading profit in your management income statements?

A Yes, sir, we do.

Q That's a real number, isn't it, sir?

A For the total corporation, it certainly is. But we don't define expenses below brand contribution as a normal course.

Q But you're not telling us that there aren't expenses below brand contribution that aren't attributable to generics, are you?

[p. 95-140] A That's why we are citing these expenses.

Q So those are real expenses that are on 3510, the Brumleve-Bacon spread sheet?

A They are not precise, but they are directional, yes, sir.

Q They are costs of dollars and cents out of Brown and Williamson's pocket, right, sir?

A With the caveat I just gave you, that they're not precise calculations as is the cost and revenues through brand contribution.

Q They're as precise as you can get them, aren't they?

A Pardon me?

Q They were as precise as you could get them?

A That's correct, sir.

Q Okay. And therefore they are real numbers, aren't they, sir?

A They are numbers, yes, sir.

Q And they are real dollars and cents?

A Yeah. A number is a number.

Q And the trading profit line is how you calculate; when you subtract the real numbers from your brand contribution level, you come up with trading profit, right?

A That's what that represents.

Q So now you're not telling me brand contribution numbers are theoretical, are you?

* * *

[Excerpt Of The Trial Testimony Of K. Elzinga]

[p. 100-151] [Q] . . . monopoly power or market power in a segment even though they, at that time, were the only suppliers of the product - generic cigarettes? Correct?

Answer: "Yes."

Q Is that as you understand it to be, what you're saying in respect to you can't have monopoly power over a segment or a corner of the market, as you've phrased it?

A Yes.

Q Now, sir, you have given us your opinion that the market here is all cigarettes. But I want you to assume, for the sake of this next question, that both you and Burnett are wrong, and that I want you to assume the market is not all cigarettes, but that - I want you to assume that there is a separate market for discount cigarettes and a separate market for full revenue cigarettes.

If there were a separate discount cigarette market, in your opinion, did Brown and Williamson ever control the growth of that segment?

MR. RASMUSSEN: Objection, Your Honor. Irrelevant. As Mr. London has said, nobody is contending that there is such market.

THE COURT: All right. Did Brown and Williamson control the growth of that market, or could they control the growth of the market?

BY MR. LONDON:

* * *

[p. 101-15] barrier to entry.

Q Well, in your opinion, sir, are there barriers to entry in the cigarette industry?

A Yes, I think there probably is a barrier to entry into the cigarette industry. It's very difficult to quantify it at this point in time, but that barrier would be the television advertising ban. As probably everybody knows, it is now illegal to advertise cigarettes over television. But there are lots of cigarette brands that are out there that have been in existence before that ban went into effect, so they had the advantage of being advertised over television.

Now a new entrant that wants to come into the cigarette industry can't advertise over that particular media. And to the extent it's the case, the television is a cost efficient way of advertising cigarettes to the extent that that's a cheaper way of getting the message out to people about your brand and promoting it relative to other media than to that extent. And to the extent those TV ads still rattle around in people's minds and have an impact upon their consumption behavior, to that extent the television advertising ban is a barrier to entry into the cigarette business.

Q Is it your opinion, sir, that there would likely be a new entry into the cigarette industry if that television ban were removed?

A That's a tough question, Mr. Burnett. Economists don't . . .

* * *

[p. 101-17] barrier that you discussed, does this demonstrate that the firms in it are in tacit collusion with one another?

A No, it doesn't demonstrate that. A barrier to entry is a necessary condition for a cartel to be a successful and profitable one, but is not a sufficient condition.

Q Now let me refer specifically to the issue that we've been addressing here. Are there barriers to existing cigarette manufacturers that prevent them from expanding from branded production sales into producing and selling low price or discount cigarettes? Is there any barrier to that?

MR. RASMUSSEN: Objection. Irrelevant. That's not at issue in this case.

THE COURT: Overruled.

A No, there's no barrier to an existing cigarette manufacturer entering into the discount segment. That's a real easy one to answer. It doesn't involve a crystal ball. They're all in there. They've all successfully entered at this point in time. But even going back before that event took place, I don't see any barrier to entry. Mr. Cohen of Liggett indicated that there were no barriers, in his opinion, into the discount segment, and I would agree with him on that.

BY MR. LONDON:

Q All right, sir. I want to turn now to the - what I recall to be the sixth item on this industrial organizational [p. 101-18] analysis done by Mr. Burnett from which he inferred his conclusion of monopoly profits, and that is

that Liggett was or is the maverick, I think is the term he used, in the cigarette industry.

How do you understand that element to fit into Mr. Burnett's analysis, sir?

A I think I can explain that. As I understand Mr. Burnett, he attaches this character to the Liggett and Myers Company, that it was the maverick, it was the renegade, it was the firm that introduced a new price point into the cigarette industry. And none of the other firms would have done this, none of the other firms liked this to happen, and all of the firms would be economically delighted if Liggett had never done that. And consequently, there would be, in his view, an incentive on the part of all of the firms, which he believes Brown and Williamson alone picked up on, to try to get Liggett out of that segment or to at least slow the growth of that particular segment at that new price point that Liggett introduced.

Q Well, in your opinion, is Liggett a maverick?

A I would call Liggett, in this context, a reluctant maverick. It did introduce the new price point, and in that sense demonstrated independence, a breaking away from the pack, if we mean by a maverick someone who strays from the pack.

[p. 101-19] The reason I say "reluctant maverick" is, as I read the record, Liggett didn't exactly forge into the discount segment on its own initiative. Topco, one of its major customers, came to it and said, "We'd like you to bring out a new price point. We'd like you to bring out a generic black and white label." And Liggett, at first,

didn't think that was a very good idea, and they kind of balked, but Topco was persuasive. Finally, Liggett went ahead. It turned out to be that Topco's advice was – and counsel – was very good advice, and it was a successful introduction.

So I would say, yes, they were maverick, but in some sense they were a little bit different kind of maverick. It took some cajoling to get them into that role.

Q Sir, once the discount segment began to develop, did other companies behave, in your view, like mavericks, or did they show independent conduct?

A Yeah, I would certainly attach the same word to Reynolds. I think that Reynolds' introduction of Doral was just as remarkable a showing of independence or maverick-like character as the introduction of a black and white or a generic. Because Reynolds, of course, was the first to take a branded cigarette, to take a cigarette that it had been selling at full revenue prices, and drop that price down to the Liggett generic level.

I would also give a maverick grade to Reynolds for [p. 101-20] introducing and promoting the 25's which, as I indicated yesterday, is a type of discount, offering 25 cigarettes for the price of 20.

And I think American's introduction of Malibu, to take a brand that purports to be a full revenue brand and kind of perpetually sticker it at \$3.00, was a maverick-like or independent-like tactic.

Q Sir, even were we to describe Liggett and Myers as a maverick, is it the only firm – pursuant to your study,

is it the only firm with a commitment to the discount segment?

A Oh, not at all. As I indicated yesterday and I think shows through on one of the exhibits that I walked through yesterday, Reynolds has an enormous stake in the discount segment. It's the largest seller. It's commitment to Doral is very significant. That's been an important development, sales enhancer for Reynolds.

And Philip Morris has a strong commitment and a kind of different one to the discount segment. Philip Morris is in the enviable position that discount cigarettes were not, to a very great extent, cannibalizing or taking sales away from its full revenue brands. Marlboro, in particular, was sitting out there, not losing very many sales to people who were switching into the discount segment. And so Philip Morris was in this position where, when it brings out a discount cigarette, that discount cigarette is, to a large . . .

* * *

[p. 101-41] didn't have enough sales in February '89 it wouldn't have an asterisk, but doesn't mean it's not out there ---

A That's correct.

Q --- is that right?

A That's my understanding.

Q And that would be the case with Brown and Williamson's Capri; is that right?

A Yes.

Q Now it's been drawn to my attention that there is an asterisk next to Capri on Page 2.

A The last entry.

Q All right, sir. Well, sir, with all of these kinds of non-list price competition that you've talked about - stickering, coupons, ad-on, advertising, new product competition, shelf payments - why isn't - in your opinion, why isn't there competition on list price as well?

A That's a good question. I thought a lot about that. I think there are two reasons why the cigarette industry seems to have a virtual absence of competition on list prices. One of them has been the topic of some discussion from a little bit different angle in this case prior to my testimony. The cigarette industry is - I won't go so far as to say it's unique, but it is - it is certainly different than most industries with regard to one characteristic of its distribution pattern, and that is a grocery wholesaler, candy [p. 101-42] and tobacco distributorm [sic] that handles cigarettes is probably going to handle the output of all six of the manufacturers, and that has an implication for list price competition.

In an oligopolistic market, when there is price competition among oligopolists, it typically occurs where the oligopolist engaging in the price cut believes that it can get some time advantage [sic] on its rival oligopolist before they are able to respond. Remember the nature of oligopoly from my discussion yesterday, it's a market setting where firms consider the likely reactions of their rivals.

And in oligopolistic competition, whether we are talking about price or non-price, oligopolists engage in competition when they think there is going to be some lag, some uncertainty in the marketplace, some at least temporary advantage that it can get over its rivals through this form of competition.

In the cigarette industry, where you have distributors who handle the merchandise of all six of the manufacturers as opposed to just one or two or three, if a cigarette company decides, "Well, I'm not going to put all of my competitive chips over on stickering and couponings. I'm going to compete on list price competition as well; I'm going to offer a price cut." That firm in the cigarette industry can pretty much count on the fact that almost immediately every other cigarette company is going to know about that form of [p. 101-43] competition. And if they all copy it, then the original firm that offered the price competition, offered the price cut, isn't any better off than it was before.

It's a matter of what forms of competition in this type of oligopoly can be quickly replicated. It's a lot harder for Brown and Williamson or Reynolds to replicate the Marlboro man, if that's the form of competition - image competition that Philip Morris chooses to adopt on that cigarette, than it would be to replicate a price cut on Marlboros.

The other factor that's going on that compliments that in the cigarette industry is - I've read testimony that, in this particular distribution channel, if a firm - if one firm raises the list price and another firm thinks, "Well, in

addition to competing on the stickering and the coupons, I'm going to compete on list price. I'm not going to raise my list price. I'm not going to follow along," there's testimony that some distributors, some wholesalers will simply go ahead and raise the price it charges on all of the manufacturers, the one that raised the list price and the one that didn't. And so the one that didn't raise its list price is, at least in that distribution channel or with those distribution outlets, not advantaged by the fact that it kept its list price at a lower level.

So there's kind of two factors going on in the [p. 101-44] distribution arrangement in this particular oligopoly, and again, I don't want to say it's unique. I haven't studied every industry, but it's different from my experience in studying industries.

Q Well, as an economist, can you tell us, in other industries does the structure of the distribution network enable competitors to change prices in a manner so that those price changes are not immediately known to competitors?

A Oh, sure. Take the television oligopoly, for example. If Panasonic decides to cut a deal with K-Mart and to offer K-Mart a very, very attractive price on Panasonic television sets so that K-Mart might have a spring special on that, well, K-Mart may be handling at most maybe one other brand of television sets. So it isn't as likely that by dint of that price reduction to K-Mart that Hitachi and Zenith and Sanyo and all of the other television manufacturers are going to know immediately about this special deal that K-Mart is going to run, so that they can immediately match or replicate that deal. So that Panasonic,

ultimately, doesn't have any sales or revenue advantage from having entered into that arrangement with K-Mart.

In the brewing industry, which is an industry that I've studied quite a bit, typically a beer distributor, let's say, a Miller distributor, doesn't handle Anheuser-Busch's beer, it doesn't handle the brands of Coors. . . . It may handle a few

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[p. 101-56] the Court three more new deposition designations: Harrison, Bagley, and Lewis, and also the revised one of Ruggiero.

Following Your Honor's suggestions, Mr. Barker and I worked it out. There's now one very minor objection; otherwise, we worked everything out.

THE COURT: All right. Thank you.

(Jury in at 11:15 a.m.)

THE COURT: All right. If the witness will come back, please.

BY MR. LONDON:

Q Dr. Elzinga, I want to change the subject a little bit, and I want to talk about income taxes for a few moments. Not yours, not mine, but Brown and Williamson's.

Mr. Burnett has testified that in his opinion any income tax savings that B & W may have enjoyed by reason of its entry into the generic segment ought not be counted for the Areeda-Turner test, the average variable cost test purposes.

Is that your understanding of his testimony?

A That's my understanding.

Q Do you agree with that?

A No. I disagree with that.

Q Why?

A I disagree with it for a couple of reasons, Mr. London. One pertains to the economic implications of handling [p.101-57] income tax or taxes the way Mr. Burnett would have it done, at least as they would apply to an Areeda-Turner test.

Mr. Burnett would say to a company, in effect, that if you have some savings on your raw materials or if you're able to come up with a way of saving money on labor costs or if you're able to buy machinery cheaper than you could buy it before, it's okay to pass all of those cost savings on to consumers. No problem under the antitrust laws with that.

Q What do you mean pass them on to consumers?

A Well, if you save a dollar on labor costs through some cost-cutting technique, you can offer that dollar in savings to the consumer and ---

Q Reflected in the price?

A That's right. You offer the consumer a dollar off. And under his calculation of prices and costs for Areeda-Turner, that would be fine.

The costs went down; the price went down. The price didn't go below cost; no violation under Areeda-Turner.

But Mr. Burnett would say to a company, "If you save any money on taxes as opposed to saving money on raw materials or labor or machinery, if the cost savings comes through an ability to reduce your tax exposure, then you may not pass that tax savings on to consumers in the form of lower prices because I'm not going to count that cost savings under Areeda-Turner. And consequently you try to offer [p. 101-58] consumers a lower price, and you may violate the Areeda-Turner test."

Now I think an interpretation – that interpretation of Areeda-Turner turns antitrust on its head because it keeps companies from being able to pass on price – cost reductions or tax savings to the ultimate consumer.

The other problem I have with his treatment of tax costs and tax savings is I think it's inconsistent. If a company has costs of operation and you suspect that this company might be a predator and you look at its costs and you find that it has costs for labor and costs for raw materials and it has costs for machinery and it has costs for taxes, well, Mr. Burnett would say, "Count all of those costs," because he thinks all of them are real costs; those that are tangible – raw materials – those that are intangible, like an excise tax payment to the federal government.

On the other hand, when it comes to tax savings to the revenue side of the equation, Mr. Burnett would say, "Well, the revenues that the consumers pay, those we want to count under Areeda-Turner. But the revenues that the firm receives in the form of tax savings, somehow those are ephemeral. They don't have any economic content to the firm, and they shouldn't be counted."

And in my judgment one should not treat tax savings and tax costs differently. I think its inconsistent. I would

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[p. 101-60] neighborhood of 80 million. Is that right? During that 18-month period?

A I don't recall, but they would be multiples of his alleged loss figure that Borwn and Williamson, in his view, sustained in going into generics.

Q Well, how does the inclusion of the LIFO tax benefits square with the rationale of the Areeda-Turner average variable cost test?

A I don't think there's any conflict. The Areeda-Turner test, as I mentioned, is a test that focuses on average variable cost.

On the cost side of the equation it says, "What are the average variable costs for this firm?" There isn't in economics a counterpart to that. There's not the concept of average variable revenue.

You could look, at least in any principles textbook that I've ever used or taught from. There's no such concept as average variable revenue. There's simply revenue.

And when Brown and Williamson goes into generics, its revenue comes in the form of two sources really on that move. One source is the sales receipts of its customers. Another source of revenue to Brown and Williamson for its move into generics was tax savings that it enjoyed as a consequence of that move.

Q Now what if one found, in the application of the test,

* * *

[p. 101-71] [A] . . . Now I look at volume rebates – I look at them as sort of, you know, the way they are looked at conventionally.

You go to a wholesaler, you go to a distributor, you go to a direct buy retail account, and you say, "The more you buy from us, the bigger will be the rebate." That's a powerful incentive. That's an economic incentive to that distributor, to that grocery chain to buy more.

Now the only reason it wants to buy more is if it can sell more.

There was some testimony from Mr. Eads that I liked. He said something to the effect that it isn't any fun being a buyer unless you can be a seller. There's no reason to buy more from Brown and Williamson unless you plan to sell more. And the volume rebate gives you incentive and an ability to sell more.

It gives you an incentive because you can take that rebate – you can pass it on to your own customers or you can pass on a portion of it. Or you can take that rebate money, and you can expand your own merchandising efforts.

So to sum up what's been a long-winded answer – and I apologize for that, but it's such an important area of disagreement between Mr. Burnett and myself – I think the logical import of his theory is that Brown and Williamson should have been offering a reverse volume rebate.

And I disagree with him that rebates have this magic [p. 101-72] quality that they don't affect downstream

consumption. I believe that when Brown and Williamson or any cigarette company offers a customer of it a volume rebate, the only way that makes sense for that customer to take advantage of that buying more is if they sell more.

If they expand their merchandising efforts in a number of ways that are possibilities to them to expand their sales of Brown and Williamson products. And to the extent they do that, that's inconsistent, of course, with the efforts on the part of Brown and Williamson to make that discount segment get smaller or not grow as fast.

Q Let me show you, sir, and ask you a question about some of the testimony to which you refer, and that is the testimony of Mr. Eads on 8/21 – 8/21, Part V, Page 2.

The witness here is Mr. Eads, and the questioner is myself. And the question reads: "And both Liggett and Myers and Brown and Williamson were paying their customers more money per carton if the customer bought more cigarettes?"

Answer: "Yes."

Question: "And that was in a series of six or seven brackets. Right?"

Answer: "Yes, sir."

Question: "And that price structure – that rebate structure gave you as a distributor an incentive to buy more cigarettes from that manufacturer. Correct?"

[p. 101-73] Answer: "It should give the distributor the incentive to sell more product from that manufacturer, not just buy, but to sell more products from that manufacturer. Yes. On that basis, yes."

Question: "And he - the more he buys and the more he sells, the more profit he makes?"

Answer: "Yes."

Question: "And because the incentive gives the wholesaler a bigger rebate on the first carton when he moves into the next bracket, that enhances, does it not, the profit motive to the wholesaler to try and become a larger and larger volume buyer? Right?"

Answer: "Certainly."

Question: "And as you wisely pointed out, sir, it's no fun being a buyer unless you can also be a seller. Right?"

Answer: "That's right."

Question: "You want to buy, and the incentive is to buy. But if you don't want to look at the cigarettes piling up in the warehouse, if you buy then you've got to sell them?"

Answer: "I don't want one free with five and end up with six in the warehouse."

Question: "And, therefore, the incentive in the rebate program causes you as the distributor to maximize your effort to sell the product because that's the way you can maximize

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[p. 101-82] In your ---

A I'm sorry. Liggett alone?

Q Liggett.

A Uh-huh.

Q In your opinion, was consumer welfare enhanced by Liggett's introduction of discount cigarettes?

A Sure, by the same line of reasoning.

Q And can you tell from your review whether Liggett, when it was the only seller of discount cigarettes, was doing the best it could to satisfy consumer preferences?

A It's always tough to assess whether a firm that's the only seller in a market or the only seller in a segment is doing the best it could.

We can look at the track record, and we can see that as Liggett faced competition in the discount segment, it did more on behalf of consumers. It expanded its merchandising efforts. It began to sticker. It found that it could increase the size of its rebates under the goad of competition.

Liggett probably isn't any different than most of us. We do better when we are paced, when we have some competition. And Liggett seemed to offer more to consumers under the goad of competition from Reynolds and Brown and Williamson and Philip Morris and so on.

Q Well, Mr. Burnett has testified essentially that it is

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[p. 101-87] happens in the American economy, rivals appear on the scene.

[A] . . . And you can't have 100 percent and have rivals appear on the scene and continue to have 100 percent. Your share is going to decrease.

And I don't think Liggett - given its position in the industry, given the competitive character of the industry - had any ability to try and exclude rivals from the discount segment. Their track record indicates that.

Q Now, sir, You said that's the one on which they apparently had little control or no control. But you said there was a second factor that lessened their share of this discount segment, and that is one over which it did have some control, but you thought that they had made a mistake. Which one was that?

A The mistake that Liggett made - the factor over which it did have control - is that having introduced black and white generics, having introduced this new price point in the cigarette industry, they stayed too long with black and white generics.

Now I think Brown and Williamson made the very same mistake. Liggett, Brown and Williamson, put their marketing focus on black and white generics.

And not too long after this component of the market - this segment is introduced, consumers find that as between black and white generics and branded generics, which Reynolds [p. 101-88] introduces, many of them would prefer the branded generic.

And Liggett didn't recognize that early enough. I don't think Brown and Williamson did either.

And as a consequence, the discount segment started to run away from Liggett. It ran away from Liggett not just because they had new rivals in that segment, but their new rivals were Reynolds with Doral and Philip Morris with Cambridge and then American with Malibu.

And a lot of consumers found themselves thinking, "Well, I've got a choice here. I can get a low-priced cigarette with a black and white plain label or I can look in the marketplace and I can get a cigarette at the same price that's got a little brand pizzazz to it." And a lot of them said, "I'll take that latter choice."

And as I say, I think Liggett and Brown and Williamson were late in recognizing that.

Q Now, sir, do you have an opinion as to why the - aside from the move to branded generics, as to why the black and white portion of the discount segment, where Liggett was concentrating its efforts in those years, why that black and white segment has been shrinking?

A Yes. I do. I think that the cigarette industry - how shall I put this? - wasn't immunized from general forces that were happening throughout the economy with regard to black and white or generic products.

[p. 101-89] There has been in recent years a slow but steady shift away from black and white products - from generic products in the grocery business where a few years ago generic products, whether we're talking about vinegar or toilet paper or peanut butter or potato chips - a whole raft of things - was starting to make a real niche for itself in grocery retailing.

The trend has been away from that. And I think that trend, which is so common in grocery retailing, is something that the cigarette industry is not insulated from.

Q I want to show you, sir, a document which is in evidence, and it is DX-3197 in evidence.

Now this exhibit is something entitled "Private Label and Generic Analysis" put out by SAMI/Burke which has been referred to here as SAMI/Burke.

Now what is SAMI/Burke?

A SAMI/Burke ---

Q Or who - I guess it's what. What is SAMI/Burke?

A It's a what. It's an organization that tracks the flow primarily of grocery products through the distribution channel.

And it - in fairly amazing detail - will track a whole array of products so that if you and I, Mr. London, sold peanut butter in Detroit and we wanted to know what are our rivals were doing in Detroit in peanut butter, we go to [p. 101-90] SAMI/Burke and if we pay them - it's not cheap to buy this information - but if we pay them, they would draw from their data base the movement of a sample of peanut butter through the grocery wholesaling and distribution channel, even into an area like Detroit, and tell us where we stand relative to our competitors.

Q Have you ever heard of or had anything to do with the SAMI/Burke reports prior to your involvement in this litigation, sir?

A Yes. I've worked with SAMI/Burke data in other assignments.

Q Have you used this kind of data in other antitrust [sic] assignments?

A Yes. I have.

Q And you consider it reliable?

A Yes. I do.

Q Now I want to show you a particular page of this Exhibit 3197, and I've blown up what is the - counting the cover - one, two, three, four, the fifth page. It's a blow-up of the fifth page of 3197.

What does that tell us? What are we looking at, and what does it tell us, sir?

A As you indicated, it's a blow-up of a page from the SAMI/Burke document. It's a page titled "Marketing in the 80's."

[p. 101-91] And the whole sheet is designed to give a sense of the trend in the 1980's as to how private label business is doing - private label across the board, private label for corn and private label for all of the kind of products SAMI/Burke tracks. And then it has below it the regular private label.

The line that was interesting to me - the only line on this that was really interesting to me is the bottom dashed line that is labeled "Generic Label," this one right here, "Generic Label."

That line tells us, according to the SAMI/Burke data, what's happened in the 80's or at least from 1980 over to the period ending March 25 of 1988.

What's happened to generic labels that SAMI/Burke tracks?

Well, take a look at that. Over here it's one percent, so it's pretty small at the start of the decade. But it's growing. It's growing slowly.

And it peaks here in the '82-'83 period. That's probably related to macro-economic trends at the time. There's a recession going on then, so lots of people are finding

generic label to be attractive, and it really is catching the attention of the grocery business.

And a lot of grocery chains are saying, "We've got to have generic label to be competitive. A lot of our customers [p. 101-92] want that. We're moving a lot of this material."

But look what happens at this year right here beginning in 1983. There's a peak, isn't there? It's just a slight peak. But if you follow that trend, there's slow but noticeable downward trend in generics to where at the end of the period registered, generics are down to a tad more than one percent.

Now that's grocery products. That's not cigarettes. But in my view that represents a general trend for a lot of consumers that, "I'm going to trade up to a branded product. I'm not as enthused any more about shopping for generics."

And the cigarette companies that came in with the plain labels - Liggett as the introducer of that, Brown and Williamson that comes in with a plain label - that trend cuts against them, doesn't it? That's not good news for them.

The consumers generally are switching away from plain labels. Then when it comes to cigarettes, they're generally going to be switching away, not necessarily to a Kool or Marlboro, but to a branded generic.

And that's what Philip Morris and Reynolds primarily were offering. And they were the beneficiaries of that trend. I think that explains a lot as to what was happening to Liggett's declining share.

Q Some questions, sir. This general trend away from black and white packaging or private label packaging, is that [p. 101-93] something that you attribute to Brown and Williamson's conduct as something for which they are responsible?

A Oh, no, no. As I said, it not only cuts against Liggett; it cuts against Brown and Williamson as well.

Q Now, sir, this opinion that the cigarette - that you've expressed here that the cigarette growth or the consumption growth will come in the branded discount segment, is that shared, is that just your own or is that shared by other industry analysts?

A I've seen that ---

MR. RASMUSSEN: Objection.

MR. FOSTER: Objection.

THE COURT: Sustained.

BY MR. LONDON:

Q Okay. Let me show you, sir, Exhibit 36 --- Is this the right number? Well, 3657. This is Plaintiff's Exhibit 3657 offered into evidence by the Plaintiff in this trial.

That's the Maxwell Report for the 1987 year end sales. Is that right?

A That's correct.

Q I wonder if you could, sir, please turn to what is the - counting the cover page, one, two, three - the third page of the report which starts with the language up at the top, "The price value category." Do you see that, sir?

A I have it, sir.

* * *

[p. 101-117] elements of our policy recommendations in this area is that antitrust enforcement be done by the government. We argued that it was a – in economics lingo – a public good and should not be provided by the private sector. Antitrust enforcement should be done by the antitrust division of the Federal Trade Commission.

But we also recommended that in the context of that enforcement, those agencies should be able to penalize violators to a far higher extent than the penalty structure now permitted. And we've moved in some direction in that area, not as far as Professor Breit and I would like.

Q But, sir, no matter how high the fines that the government might impose, that still would not allow the injured victim to get any compensation whatsoever under your proposal.

A That's correct.

Q In fact, you just mentioned Mr. Breit – you and he appeared on a panel to discuss this very issue, didn't you?

A More than one, I believe.

Q And one of the panel discussions took place in the mid-seventies, approximately ten years before you were hired by B&W's counsel; isn't that right?

A Are you referring to the American Bar Association meeting in San Francisco?

Q Yes. I think I am. It's the American Bar Association. . . .

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[p. 101-154] THE COURT: Page 13, bottom paragraph.

BY MR. RASMUSSEN:

Q Professor, could you read for us, on page 13 of your report, the first full sentence at the last paragraph of that page?

A Only the first sentence?

Q That's all I'd like you to read.

A All right. "We ---"

Q Go further, if you'd like.

A "We intend to study price and cost data to ascertain whether and by how much Brown and Williamson's net prices of generic cigarettes exceeded the average variable costs of producing them."

Q Go ahead and read the next sentence.

A No, I was just asking you if the first sentence was all you wanted. I'll glance at the second one.

Q I like the second, too, so go ahead and read it.

A All right. "This comparison will be based on the deposition testimony of witnesses familiar with Brown and Williamson's prices and costs, our discussions with them and on the work of Professor Roman Weil."

Q Who is Professor Roman Weil?

MR. LONDON: I object to this, Your Honor. May we approach?

THE COURT: Yes, sir. Well, let's --- What. . . .

* * *

[p. 101-158] [Q] . . . started out with, which is this morning you testified that you were going to - if you were going to do a study of average variable cost, you would look at all of Brown and Williamson's cigarettes and compare their prices with their average variable costs. Now in your report you said - that you just read - you intended - you and Professor Mills intended to study the prices and the average variable costs of generic cigarettes. Isn't that right?

A Yes. Would you like me to explain that?

Q Excuse me?

A Would you like me to explain that?

Q Well, I'm coming to that right now.

A Okay.

Q And indeed the reason why this morning you said you hadn't looked to all cigarettes was because the relevant market was all cigarettes. Isn't that right?

A That's one reason.

Q But yet at the time of your report you knew that the relevant market was all cigarettes, but you still put that language in your report. Isn't that right? Look at page 13 of your report about what the relevant market - page 17 where you concluded that the cigarette market was the relevant market back in August 1986. Isn't that right?

A That's right. Am I now at the point where I can explain?

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[p. 101-164] [Q] . . . ascertain whether and by how much Brown and Williamson's net prices of generic cigarettes exceeded the average variable cost of producing them," close quote.

And then I asked, "Is it appropriate from an economic viewpoint to compare the net prices of generic cigarettes to the average variable cost of producing them?"

And you said, "I think it's appropriate to consider that, although in this particular instance the price narrowly defined and cost narrowly defined doesn't embrace all of the factors behind Brown and Williamson's decision to move into generics."

Isn't that what you said on October 21, 1986?

A Yes, that's what I said on October 21, 1986, and all I can say is since that time period I haven't just put my brain in neutral because something happened on October 21, 1986. I've considered to - continued to mull over these issues and --- Well, I can't expand upon what I said earlier.

Q There was no doubt in your mind at the time of your deposition which was in October 1986 that the proper market, in your opinion, was all cigarettes?

MR. LONDON: Objection. Again, that's the third time.

THE COURT: All right. One more time.
BY MR. RASMUSSEN:

Q This was at the deposition, not the report. This was . . .

* * *

[p. 101-197] Do you see where I asked him – there it is – “Did B&W price above or below average variable cost in 1984 and 1985?”

“Pre-tax trading profit was negative. Therefore, if you disregard financial consequences, other than direct sales revenue and what you refer to as price, the answer would be that prices are below average variable cost.”

And you agree with Professor Mills’ testimony, don’t you?

A I don’t really recall for certain whether pre-tax trading profit was negative. It seems to me that it was.

Q Which means then you would agree with Professor Mills’ testimony?

A Well, I agree with his answer to that question. I don’t know if I agree with his whole testimony, but he says, “Sure. Pre-tax trading profit was negative. Therefore, if you disregard financial consequences, other than direct sales revenues and what you refer to as price, the answer would be that prices are below average variable cost.” But I think Professor Mills, in the context of what he’s saying, is it would be wrong to disregard the other financial consequences.

Q In your report ---

MR. FOSTER: Objection to what he thinks Professor Mills meant. If it ---

THE COURT: All right. Sustained to that unless it’s an explanation of something further.

MR. LONDON: It’s right in the previous page of this [p. 101-198] deposition, Your Honor. Just what he objected to.

THE COURT: All right, sir. Go ahead.

MR. LONDON: The witness was absolutely correct on the previous page.

THE COURT: You may explain if it’s something from the deposition or his previous testimony.

BY MR. RASMUSSEN:

Q But, sir, when you’re looking at just prices and average variable cost of producing and distributing generic cigarettes in 1984 and 1985, and if you’re doing that on a pre-income tax basis, there is no doubt, is there, that B&W did price its generic cigarettes, pre-income tax, below the average variable cost of manufacturing and distributing them?

A Well, if you did that, which I think is the wrong comparison to make, I believe you would find that pre-tax, the price of B&W’s generics was below the average variable cost of B&W’s generics.

Q Thank you, sir.

Now, sir, I’m going to move in a minute to the tax issue, but there’s one point about cost that I want to clear up before I go into the income tax consequences.

A Okay.

Q You believe, don’t you, that imputed interest cost --- Well, let me start out – what is an imputed interest cost?

A As I understand the term, an imputed interest cost is an

* * *

[p. 102-96] you believed it.

A Well ---

MR. LONDON: Do you have a date?

A You have to understand "Mergers: Their Causes and Cures" was written while I was a student of Dr. Adams. That was for my doctoral dissertation which he directed.

BY MR. RASMUSSEN:

Q Okay. Do you agree ---

MR. LONDON: Do you have a date on that, Your Honor, that he took the quote from?

THE COURT: What? The Scherer book?

BY MR. RASMUSSEN:

Q Do you know the date of that article, sir?

A Well, I can't remember when the article finally came out. The words would have been written back in - gracious - 1967 or '66. Those were the years I was working on my doctoral dissertation.

Q Do you agree or disagree with the following?

"According to economic theory, when consumers face a tightly knit oligopoly, the price they pay is likely to be elevated."

A Yes, in the case of a tightly knit oligopoly. That is, where the oligopolists don't compete with one another.

The prices that consumers pay - what was it - are likely to be elevated?

[p. 102-97] Q Yes.

A Yes. I agree with that.

Q And, indeed, what is the market share of the leading four firms in the cigarette industry? Approximately 85 to 90 percent, isn't it?

A I suspect so. I'll take your word for it.

Q Well, take the lower number. Now on direct in questions - in answers to questions from Mr. London you said that oligopolies are common. And you said, I think, half of the industries in the United States are oligopolies. Right?

A My recollection is in the Scherer textbook you might find an estimate on that, something like half of the manufacturing industries are considered to be oligopolies.

Q And that is using a definition of oligopoly which you gave yesterday of any industry that has 12 or fewer firms. Isn't that right?

A Not exactly. I indicated yesterday it's tough to put a number on how many firms in an industry constitute oligopoly.

I was asked and I suggested a range of from 3 to 12.

Q Okay.

A That's not to say you couldn't show me an industry with 13 firms where the firms are all fairly equally

sized and when one takes a major competitive step in one direction, it considers the reactions of some of its other rivals.

That, of course, is the essence of an oligopoly.

* * *

[p. 102-99] handful of those firms that were in control of 85 percent of the market. I might still call that an oligopoly, even though, "Hey, is the number of firms between 3 and 12?" No. The number is out here at 500.

Q By your testimony yesterday you didn't mean to suggest that industries as concentrated as the cigarette industry were common, did you?

A No. I was asked whether oligopolies were common.

Q Right.

A And I said, "Well, probably half the manufacturing industries are oligopolies."

Q In fact, the chart that you just --- I want to show you a chart from Scherer's book and see if that's the chart you were just referring to. A Xerox of the chart is on Page 83.

MR. LONDON: Could we have a copy of that, please?

MR. GLAZER: We've labeled this board here Plaintiff's Exhibit 7724, the board that Mr. Rasmussen wrote those numbers on.

(The board above
(referred to was marked
(for identification as:

(PLAINTIFF'S EXHIBIT
(NO. 7724.

BY MR. RASMUSSEN:

Q Now isn't it true, sir, that only about 5 percent of the industries in the United States have a concentration -- a [p. 102-100] four-firm concentration ratio of more than 80 percent?

A Well, is there a prior question as to whether this tab is the one from which I had my recollection of the 50 percent figure?

Q Is it?

A No. It's not. I thought it was in the text; that is, in the written portion. I honestly don't remember the table I'll be happy to try and answer questions from it, if you like, but I thought that -- again, this is from, you know ---

Q Let's put aside the table.

A Okay.

Q Do you agree that only approximately five percent of the industries in the United States have a four-firm concentration ratio of more than 80 percent, based on the 1982 census of manufacturers?

A As I understand your question, I think the answer is yes or at any rate, that's what the table shows.

When you say industries, you're not talking about markets then. You're talking about the government classification of SIC - what is this - four-digit probably industries?

Q Yes.

A Yes. The way the government classifies industries, which, as you know, doesn't always correlate with a real world economic market, the government finds that the number [p. 102-101] of industries with four-firm concentration ratios in 1982 ranging from 80 to 100 is 23.

And that's about five percent of all industries.

Q Now moving to another one of the elements that Mr. Burnett mentioned in his market analysis, pricing patterns. Was it your testimony that Mr. Burnett's conclusions about pricing patterns were of no help to you in trying to determine if there were monopoly level profits in the cigarette industry?

A "No help" is awkward for me to interpret. Let me see. If you're asking me was Mr. Burnett's testimony about list price uniformity persuasive to me that there was a tacit cartel, the answer would be no.

Q I gathered that. Was it of any interest to you? Was it simply an irrelevant exercise that you did?

A No. It was of interest to me. I was asked to analyze and assess his theory. Obviously, I took an interest in it. I just didn't agree with it.

Q It's something that economists look at when they do market studies, isn't it? Pricing patterns?

A Sure.

Q And this --- I want to read you something from Professor Walter Adams' book again, *The Bigness Complex*, at Page 199. You are aware that he discussed in that book the cigarette industry, aren't you?

[p. 102-102] A I don't recall that, but he may well have.

Q And he published this book in 1986?

A That's correct. I remember chapters and long discussions on steel.

Q Do you see that paragraph on the tobacco industry?

A Yes. I do.

Q And do you see at the end of that paragraph he writes - writing in 1986 that the industry - "The industry continues to exhibit extraordinarily uniform non-competitive oligopoly pricing"?

A Yes. I see that.

Q Do you disagree with Professor Adams?

A Well, I disagree with the sentence, and I disagree with the context in which you read it here.

He's talking about - and I'm quoting - "The three lineal descendants," that is of the Supreme Court. May I say that, Supreme Court opinion?

There was a Supreme Court case in 1946 that he's talking about, and he refers to the three lineal descendants of that case which are American Tobacco, Liggett and Myers, and R.J. Reynolds.

And he says, "They have collectively and unlawfully monopolized trade in part through a remarkably parallel pattern of predatory pricing and leaf tobacco purchases designed to crush independents whose competition threatened [p. 102-103] the Big Three's tacitly collusive price structure.

"No structural relief was ordered in this second case. The highly concentrated structure of the industry remained intact, and the industry continues to exhibit extraordinarily unifrom [sic] non-competitive oligopoly pricing."

Well, I would have to wonder if Walter is aware that in saying that the structure of the industry remained intact - that is, that's the quote - that Liggett has fallen into the position that it has and so has American Tobacco.

I think Walter's talking about a very different industry here, very different structural or organizational setting for the market.

Q And didn't you say this is written in 1986?

A That's correct. It was published in 1986.

Q And Mr. Scherer has a book, *Industrial Market Structure in Economic Performance*, which he published in 1990. This is the third edition. Let me show it to you.

A Thanks, I haven't seen this.

Q You've read his second edition?

A Yes, I have. I didn't know the third was out.

Q And he talks about the cigarette industry in the third edition, doesn't he?

A It appears that he does.

Q I want to read to you what he says about it.

"Despite these changes in leadership roles and the [p. 102-104] proliferation of differently priced king size, extra long, mentholated and low tar brands, there was little indication of intensified price rivalry among the cigarette makers. Indeed, despite a doubling of federal excise taxes to 16 cents per pack in 1983, the reappearance of low-priced brands and falling consumption, the leading U.S. cigarette manufacturers raised prices sufficiently to increase their profits from \$3.80 to \$11.55 per thousand cigarettes sold between 1980 and 1988."

Did I read that correctly?

A With the omission of the footnotes, you read it correctly.

Q Does Mr. Scherer have it wrong?

A Does he have what wrong?

Q Is his analysis mistaken because of what ---

A Well, if you ask me to take just this one paragraph and say do I think this reflects competition in the cigarette industry today, as I've indicated, no. I disagree with Professor Scherer if that's all he's saying.

As I've indicated, competition occurs on a number of vectors in this industry. And I also tried to explain why I thought it didn't occur on wholesale list prices.

Q These are profit margins. Profits are after you take out the non-price competition, and they've gone up from three eighty to eleven fifty-five per thousand. Isn't

that right? [p. 102-105] Aren't profits calculated after you take out your non-price competition, like stickering and shelf space payments?

A Well, are you saying that the three eighty to eleven fifty-five per thousand doesn't embrace advertising or promote its own expenditures of any sort?

Q I'm saying it does. Doesn't it?

A I'm not sure what Professor Scherer is measuring here. He's not giving a rate of return figure there. He's talking about a margin.

Q Now let's turn to accounting rates of return. Mr. London read you a passage from Franklin M. Fisher and John A. McGowan from Charles Rivers Associates which is Mr. Burnett's firm.

Did that passage - should that passage be interpreted as meaning that economists should never look to accounting rates of return in conducting a market analysis?

A Can you remind me of the passage? I think I know the thrust of it, but I ---

Q It's the one you quoted in "Unmasking Monopoly."

A Could I see that?

THE REPORTER: In - what was the title please?

MR. RASMUSSEN: "Unmasking Monopoly."

A Could I see that please?

BY MR. RASMUSSEN:

Q Sure.

[p. 102-106] You probably know the article better than I do, so you can find it. I know you quoted it.

A I'm not sure about all that at this point in time. I think you've read all this more recently than I have.

THE COURT: Okay. What is the question?

BY MR. RASMUSSEN:

Q Should we interpret or do you interpret that phrase that Mr. London read to you but didn't ask you any questions about to mean that economists should never look at accounting rates of return in trying to conduct a market analysis?

A I'm looking for a quote from the Fisher/McGowan article.

THE COURT: Well, I think that's the question. Do we need to look at that article? I mean, are you trying to ask him whether economists should look to accounting rates of return?

BY MR. RASMUSSEN:

Q You don't remember what Mr. London read yesterday in court?

A I really don't. Was it read at a bench conference or read to me?

THE COURT: Okay.

MR. LONDON: I'm handing the witness a copy of the article - the material that was read to the Professor.

I'm pointing out his mark by the orange tab at the top, and the orange highlighting on the four things that Mr. Rasmussen is [p. 102-107] asking about.

THE WITNESS: Okay.

A You're asking me do I agree with Professor Fisher and Mr. McGowan that accounting rates of return, even if properly and consistently measured, provide almost no information about economic rates of return.

BY MR. RASMUSSEN:

Q Well, you can answer that one first. Then I have another question.

A I'm somewhat on this issue like King Agrippa was when the Apostle Paul was trying to convert him. I'm almost persuaded. I moved in this direction a long ways from when I was a student of Walter Adams.

If Frank Fisher is saying never even look at them, well, I'm too interested in data to take that counsel. Where he said "provide almost no information about economic rates of return," I and a lot of economists have moved very much in that direction.

Q But you haven't gone to that extreme, have you?

A No. When I do a descriptive article on an industry and it comes to a section on profits, I put in the accounting profits. Some people are interested in those, but I try and caution the reader, "Look, you've got to look at this stuff with real caution because there's a lot of slippage between an accounting rate of return and an economic rate of [p. 102-108] return. And when you get

an economic rate of return, you still might not have a monopoly rate of return."

Q So Mr. Burnett is not the only economist that looks at accounting rates of return, is he?

A No. Not at all.

Q You do too?

A Yes. I do.

Q You mentioned risk in connection with why we should not pay any attention to accounting rates of returns. That was one of the three reasons. And you talked about products - product liability cases, health cases. Do you remember that?

A Yes. I do.

Q Isn't it true that a plaintiff has never won one of those cases and had a victory sustained on appeal?

MR. LONDON: I object.

THE COURT: Sustained. Sustained.

MR. LONDON: That is ---

MR. FOSTER: Your Honor, may we approach?

(Bench conference on the record.)

THE COURT: We're not going to start talking about court cases and what was affirmed and what was sustained.

MR. GLAZER: I just want to remind Your Honor that Mr. London cross examined about the *Chipolone* case in New Jersey where the plaintiffs won at the

trial level, and Mr. London was trying to make a point that it shows how risky

* * *

[p. 102-128] MR. RASMUSSEN: Maybe Ken has.

THE COURT: You mean you-all can't all do that in your head?

MR. RASMUSSEN: Mr. Glazer can, I'm sure, but not me.

A Okay. Sorry for the delay. Subject to check, the figure for 1988 – the Herfindahl-Hirschman index for the cigarette industry according to the Maxwell Report stats would be 2798.

Q So it is higher in 1988 than it was in 1984?

A By that measure, yes.

Q And it's well above the 1,800 level which is the definition of high concentration in the Justice Department guidelines?

A Yes, sir.

Q Now, sir, assume after a careful nuts and bolts economic study, you determined that an industry actually had super-competitive profits – I'll use your term, monopoly profits. Would you change your mind about the existence of monopoly profits if the president of the smallest company, who was a businessman and not an economist, truthfully says that his company was making a fair profit?

A I'm sorry. I don't understand the question. You are asking me to assume that I or a group of economists I

am working with – if we decide that here's an industry that really is making monopoly profits?

[p. 102-129] Q Yes. And you do that after careful study.

A Uh-huh. And a president of a company in that industry says, "I'm only making fair profits"?

Q Yes.

A And what would I conclude from that?

Q Would you change your mind?

MR. LONDON: Your Honor, I object to the form of that question. Is he going to make the president the plaintiff who is making the allegation? There's quite a difference.

THE COURT: Well, is there a difference --- No, I'm going to --- if he can answer it, he can. If there's a difference or a similarity between fair profits and monopoly profits or do people use the terms differently. You may answer that question that he asked, if you can.

A Well, if those are the only facts I had, I probably wouldn't put a lot of weight on the testimony that the profits were fair. I might not know what the manager meant in the regard.

Q What if the manager told you – and this is a non-economist – what if the manager told you that he thought there's a lot of competition in the market every day of the year? Would you change your mind after careful economic study?

MR. LONDON: Object to this question.

* * *

[Excerpt Of The Trial Testimony Of J. Winebrenner]

[p. 104-184] the payments that you testified about being made when Doral was reintroduced. And the first is the volume incentive. At the top level, sir, in May of 1984, how much was the payment per carton for Doral?

A At the highest level it was 16 cents per carton.

Q All right, sir. And then the next is the introductory allowance that you just mentioned. How much was that per carton, sir?

A That was 16 cents a carton.

Q All right, sir. Now I believe you mentioned terms. How much was that, sir - as compared to Liggett, how much of a benefit was that to the customer?

A I believe the differential, as stated in the other document, was about five cents.

Q All right, sir. Did you provide racks, sir?

A Yes, we did.

Q Did you charge for those?

A No, we didn't.

Q Did you provide ad slicks?

A Yes, we did.

Q Did you charge for those?

A No, we did not.

MR. MICHAEL ROBINSON: For the record, Your Honor, this easel or board is Defendant's Exhibit 8902.

BY MR. MICHAEL ROBINSON:

* * *

[p. 104-211] believe Brown and Williamson or Liggett's intent was.

BY MR. MICHAEL ROBINSON:

Q Mr. Winebrenner, from your experience, sir, in marketing cigarettes and based on your observation of the value for money segment in the summer of 1984, could Brown and Williamson have competed effectively in the sale of generic products without paying rebates?

MR. TOPMAN: Objection.

MR. FOSTER: Objection.

THE COURT: Overruled.

A I believe that without the allowances, they would have had a difficult time. It would have put them at a competitive disadvantage.

BY MR. MICHAEL ROBINSON:

Q Let me ask you to look again, please, sir, at page 41 of Defendant's Exhibit 3461. Down at the bottom, sir, under Brown and Williamson, it indicates, does it not, sir, "B&W has introduced with a more favorable volume incentive trade program than either Liggett or Doral." Is that correct, sir?

A That's correct.

Q What payment or program is that referring to, sir?

A This is comparing the programs that we discussed for Doral and for Liggett that involved the escalating payment, based on number of cases purchased per quarter. And I believe in our case it was nine sixty maximum. And this one . . .

* * *

[p. 104-240] MR. MICHAEL ROBINSON: Your Honor, I believe it's the one that I mismarked Defendant's Exhibit 547, which you pointed out should be 3461. It's the July 19, National Expansion Authorization.

THE COURT: Plaintiff's 7008?

MR. MICHAEL ROBINSON: No, sir.

Your Honor, here's an extra clean copy.

THE COURT: Well, I'm sure I've got it, if you'd just ---

MR. MICHAEL ROBINSON: Yes, sir.

THE COURT: All right. Go ahead. I've got it.

BY MR. MICHAEL ROBINSON:

Q Let me ask you to look down here, sir, on Page 2 of that document under, "Payback, 96.2 months." Is that the period of time, sir, that Reynolds in its national expansion document planned it would take to break even?

MR. BARKER: Objection Your Honor. Could we have a definition of what this witness means by break even?

THE COURT: Yes, sir. Sustained.

BY MR. MICHAEL ROBINSON:

Q What does the "Payback, 96.2 months," refer to, sir?

A That's the period of time at which the cumulative losses would have been offset by profit. In other words, after 96 months, the total losses would have been equaled by a profit.

Q Did Doral, in fact, lose money for the first several

* * *

[p. 107-34] Q Sir, how does the profits that R. J. Reynolds makes on its tobacco business compare with profits it makes on its non-tobacco-related business?

A Generally, the tobacco profits are higher than non-tobacco.

Q Now, sir, I'd ask you to turn to your binder again, if I may, to Tab 5 of the binder. That's the Maxwell Report for 1987, right?

A Yes, it is.

Q Sir, if you'd turn to the second page of the exhibit under "Full year commentary," I'd like to read to you, sir, the second paragraph here.

It says, "As expected, the manufacturers announced price increases in December. Not only were these price hikes higher than those in the past, but the price value brand increases were even larger than those for standard price brands."

Would you agree with that statement, sir?

A Yes.

Q And the next sentence says, "Clearly, the industry is carefully watching and controlling its profit margins and making significant strides and improving the profitability of the lower-price segment as it becomes a more important contributor to sales."

Would you agree with that statement, sir?

[p. 107-35] A Yes.

Q Now, Mr. Winebrenner, you're appearing here today and the prior days at Brown and Williamson's request; isn't that right?

A The company was subpoenaed to participate and provide testimony, and I was chosen to represent the company.

Q And you met with Mr. Robinson about two or three weeks ago and went over some questions with him, didn't you, sir?

A Yes, I did.

Q And he showed you some of the documents that he was going to show you on his direct examination, right?

A Yes, he did.

Q All right. And I haven't gone over my questions with you today and two days ago, have I, sir, with you?

A No, you haven't.

Q Sir, isn't it also a fact that Mr. Robinson's firm represents R. J. Reynolds?

MR. LONDON: Objection, Your Honor.

THE COURT: Sustained.

MR. BARKER: Your Honor, may we approach?

THE COURT: All right, sir.

(Bench conference on the record.)

MR. FOSTER: Isn't that an appropriate question with regard to bias that this witness's company is represented by the same people that are here trying this case?

* * *

[Excerpt Of The Trial Testimony Of R. Ray]

[p. 107-119] MR. MILLER: All right, sir.

BY MR. NORWOOD ROBINSON:

Q Mrs. Ray, do you recall signing a Brown and Williamson Tobacco Corporation promotional performance document such as this?

A Yes. I signed one.

Q Such as that? And did you, in fact, use the 10 cents a carton of your B & W rebate and stickering as called for in that document?

A Yes. I did.

Q How did that affect the price that the consumer paid for Brown and Williamson generic cigarettes?

A It lowered the price to the consumer.

Q As an example, if the B & W rebate were 65 cents and you used 10 cents of it for stickering, as you were required to do, then 10 cents was automatically passed to the consumer, was it not?

A That's correct.

Q And from the remaining 55 cents, is it correct that you spent that money in the ways that you have earlier described to us, that is, through the racks and five cent a carton to your salesmen and so forth?

A That's correct.

Q Did Liggett require that any of its rebates be used in stickering or promotion to the consumer?

[p. 107-120] A Occasionally in promotion, but I am not knowledgeable of any stickers that Liggett asked me to put on any products.

Q Did any of your competitors carry Brown and Williamson or Liggett generics?

A Did any of my competitors?

Q Yes, ma'am.

A I would assume so. Yes.

Q From your observation, what did your competitors do with the rebates they got?

MR. FOSTER: Objection.

THE COURT: Well, sustained.

BY MR. NORWOOD ROBINSON:

Q Do you have knowledge of what the competitors did with the rebates other than what you've already testified?

A Not other than I've testified.

Q Do you have an opinion satisfactory to yourself as to whether Brown and Williamson's offering of rebates affected competition in the cigarette market?

MR. FOSTER: Objection.

THE COURT: Overruled.

A It increased competition in the value-for-money segment.

BY MR. NORWOOD ROBINSON:

Q Can you tell us how it did that, please, ma'am, what ways it affected competition?

A Well, I would say it made us more aware as to distributors, [p. 107-121] it made us pay a lot more attention to the category. It got the consumer a variety of products to choose from at a lower price, and it made everybody come back, even Doral and Liggett, and lower their price, put more stickering out there.

And the consumer was getting a better deal.

Q Mrs. Ray, given that Liggett offered incentives on their generic cigarettes and Reynolds offered incentives on Doral, from your point of view was it necessary for Brown and Williamson to offer incentive rebates if it expected to get in this segment?

A I would not have bought the product had it not had a rebate.

Q Did Mr. Schoenheiter offer you any extra money to sell just B & W generics and to drop Liggett generics?

A No.

Q Did anyone from Brown and Williamson at any time offer you extra money or anything else to drop Liggett's cigarettes?

A No.

Q Did Mr. Schoenheiter or anyone at Brown and Williamson ever ask or even suggest that you drop Liggett cigarettes?

A No.

Q Did Mr. Schoenheiter or anyone at Brown and Williamson ever pressure you not to sell Liggett or Doral or to sell

* * *

[p. 107-147] Q What is the most recently announced list price for GPC cigarettes sold by Brown and Williamson?

A We received a Mailgram this Monday that lowered the price of GPC's to 23 dollars a thousand on the king size.

Q Is that the same price as other companies' products like Pyramid and - is there another one? - product that sells?

A Pyramid, Malibu, I believe is in that price, and there's one - Bristol from Philip Morris is that price, and there may be one other one.

Q Well, then, at least four of the manufacturers today have cigarettes at that price level, right?

A That's correct.

Q In your opinion, Ms. Ray, did Brown and Williamson's introduction of its black and white cigarettes in any way result in the sale of fewer black and white cigarettes?

MR. FOSTER: Objection.

THE COURT: Overruled.

A No.

BY MR. NORWOOD ROBINSON:

Q Do you have an opinion as to why the black and whites have declined in your business while the total value for money segment has increased?

MR. FOSTER: Objection.

THE COURT: Overruled.

A The black and white has declined because the consumer [p. 107-148] has a choice of a branded product at a cheaper price now and most consumers would rather be seen with a package that has a brand identification than with a black and white package.

Q Ms. Ray, do you know of any time since you became involved in the cigarette business, when the competition between cigarette manufacturers was any greater or more vigorous than it is today?

A No.

MR. NORWOOD ROBINSON: I have no further questions, Your Honor. You may examine.

THE COURT: All right. Any questions on cross examination?

MR. RASMUSSEN: Yes. I have a few questions, Your Honor.

CROSS EXAMINATION

BY MR. RASMUSSEN:

Q Good afternoon, Ms. Ray, I'm Gary Rasmussen with Liggett and Myers Tobacco Company. We've never met before, have we?

A No.

Q And do you know what a deposition is?

A Yes.

Q That's where you sit down and a court reporter takes down testimony?

A Uh-huh.

Q You were never deposed in connection with this case, were . . .

* * *

[Excerpt Of The Trial Proceedings: Court]

[p. 111-75] . . . response to the promotional price of the defendant, and the incentive is not there for the customers to look at the promoted product because the promotional price is no longer attractive. So there is another round and another round and another round.

How does a new product – a new entrant get into the market in that scenario?

MR. FOSTER: They can lower the price promotionally down to, but not below, average variable cost. If they have to lower it below average variable cost in order to get in, then they can't get in because what it means is that the existing firm is more efficient than the firm coming in.

THE COURT: I understand your position.

MR. HOGELAND: It's also ---

MR. LEFELL: Your Honor, may I respond to Mr. Foster's comment?

THE COURT: Yes.

MR. LEFELL: The law is clearly to the contrary. In any case that I'm aware of where it involves a new entrant – and I cite to Your Honor, for example, the FTC case involving General Foods – the FTC specifically held that you exclude the average variable cost test promotional price cuts. Mr. Foster is drawing on cases that don't involve new entrants altogether, and I don't see how he can argue from that to what the proper results should be in a case like . . .

* * *

[p. 111-79] MR. RASMUSSEN: Yes. Just one small point, Your Honor. There is a growing body of law called non-price predation where predatory practices are established, not by intent documents but by conduct which is non-price conduct. Indeed, Mr. Sobol's article which I'll provide to you this afternoon is the leading treatise on it. Areeda and Turner discuss it in their treatise. The FTC is now actively looking for non-price predation cases. It is a recognized theory of predation.

THE COURT: Well, I'm not going to charge the jury, though, that they can find predation in this case, if there's above average variable cost pricing.

MR. RASMUSSEN: No. I'm not asking that, but certainly the black and white package can be regarded as non-price predation as well.

THE COURT: Well, that's some language that I can work with.

All right. We've gotten – the defendants have a number of Sherman Act type defenses under the heading of affirmative defenses, at least under the heading there of affirmative defense or business justification. Now the way the scenario will work, of course, the jury will have already found or been instructed if they – before they get to the predatory intent – I mean, affirmative defense – they will have already given some consideration to predatory intent and . . .

* * *

[p. 112-85] that it was on cigarette packages, the whole thing.

Yes, sir?

MR. HOGELAND: Your Honor, I know it's the eleventh hour ---

THE COURT: Time to go.

MR. HOGELAND: --- but this whole market segment concept is also the eleventh hour. I don't think it's been in this case before today.

THE COURT: Mr. Hogeland, you wouldn't even be here if it wasn't in this case. You wouldn't have gotten past summary judgment if it wasn't in the case.

MR. HOGELAND: Well, Your Honor, I admit now it's been over a decade since I did a market segment case in the *Brown-Shoe* sense.

THE COURT: I'm going to do - I'm going to instruct them on market power in a market subsegment. I am going to - I did not mean to indicate, necessarily, the use of the words "price value" when looking at the AVC test.

MR. HOGELAND: I understand that, Your Honor. You did clarify that. But the concept of market segment in the *Brown Shoe* sense we have - this whole case has been brought here on both sides agreeing that the relevant market for entry to competition, and measuring the impact of competition, is the market for all cigarettes.

THE COURT: Right.

[p. 112-86] MR. HOGELAND: Now if the plaintiff - I confess, I'm not up on *Brown Shoe*; it's been a

decade. We have not tried this case - we have not tried to put in evidence establishing in a *Brown Shoe* context a separate market segment for generic cigarettes. I don't know whether we could have or should have, but we didn't.

THE COURT: Well, you've got to have market power somewhere and if you are saying forget the segment, I'm sure the defendants will be happy to do that, and let me charge on market power and the market as a whole.

MR. HOGELAND: I understand, Your Honor. I'm not talking forget the segment. I'm simply saying that the market segments in the *Brown Shoe* sense are not part of the Robinson-Patman Act issue. And the *Brown Shoe* criteria are criteria that have not been in this case.

THE COURT: That's fine. If the defendants don't want - I mean, if the plaintiffs don't want that, I will restrict it to the cigarette market as a whole.

MR. RASMUSSEN: Your Honor, could we have an opportunity to consider that over lunch and get back to you this afternoon on that issue?

THE COURT: No, sir. Just tell me one way or the other. I mean, I will instruct them the market power in the cigarette market as a whole.

MR. RASMUSSEN: Your Honor, we do not want an . . .

* * *

[p. 115-10] juror, and for you, if you want.

All right. Marshal, if you'll bring the jury in, please?

(Jury in at 9:40 A.M.)

THE COURT: Good morning.

ALL JURORS: Good morning.

THE COURT: All right. Ladies and gentlemen, it's my turn now, I suppose. And you've heard all of the evidence, the arguments of counsel, and it's my duty to give you the instructions of the Court concerning the law applicable to this case.

It's your duty as jurors to follow the law as I shall state it to you and to apply that law to the facts as you find them from the evidence in the case. You are not to single out one instruction alone in stating the law, but must consider the instructions as a whole. Neither are you to be concerned with any – with the wisdom of any rule of law stated by me. Regardless of any opinion you may have as to what the law is or ought to be, it would be your violation of your sworn duty to base a verdict upon any view of the law other than that given in the instructions of the Court, just as it would be a violation of your duty as the judges of facts to base a verdict upon anything other than the evidence in this case.

Now I am going to give you this afternoon, each of [p. 115-11] you, copies of the jury charge that I am giving you now, when I get a clean copy. But I would ask you to pay particular and close attention to these instructions as I am giving them to you now, and not necessarily rely on the written copy of the instructions that I will be giving to you later.

Now in deciding the facts of this case, you must not be swayed by prejudice or favor as to any party. Our

system of law does not permit jurors to be governed by prejudice or sympathy or public opinion. Both the parties and the public expect that you will carefully and impartially consider all of the evidence in the case, follow the law as I give it to you, and reach a jury verdict regardless of the consequences.

This case should be considered and decided by you as an action between persons of equal standing in the community, and holding the same or similar stations in life. A corporation is entitled to the same fair trial at your hands as is a private individual. The law is no respecter of persons, and all persons, including corporations, stand equal before the law and are to be dealt with as equals in a court of justice.

When a corporation is involved, of course, it may act only through natural persons as its agents or employees. And in general, any agent or employee of a corporation may bind a corporation by his acts and declarations made while acting within the scope of his authority delegated to him by

* * *

[p. 115-13] The lawyers in this case are not guilty of anything except possible overexuberance at times, and don't be concerned with anything that I may have said as a result of any evidentiary disagreements or any other discussions we had during this trial. I would be pleased to have any of the lawyers in this case represent me at any time.

So while you should consider only the evidence in the case, you are permitted to draw such reasonable

inferences from the testimony and exhibits as you feel are justified in the light of common experience. In other words, you may make deductions and reach conclusions which reason and common sense lead you to draw from the facts which have been established by the testimony and evidence in the case.

Now I said that you must consider all of the evidence. This does not mean, however, that you must accept all of the evidence as true or accurate.

You are the judges of the credibility or believability of each witness and the weight to be given to his or her testimony. In weighing the testimony of a witness, you should consider his relationship to the plaintiff or to the defendant; his interest, if any, in the outcome of the case; his manner of testifying; his opportunity to observe or acquire knowledge concerning the facts about which he or she testified; his candor, fairness, intelligence, and the extent to which he or she has been supported or contradicted by [p. 115-14] other credible evidence. You may, in short, accept or reject the testimony of any witness in whole or in part.

Also, the weight of the evidence is not necessarily determined by the number of witnesses testifying as to the existence or non-existence of any fact. You may find that the testimony of a smaller number of witnesses as to any fact is more credible than the testimony of a larger number of witnesses to the contrary.

A witness may be discredited or impeached by contradictory evidence by showing that he or she testified falsely concerning a material matter, or by evidence that

at some other time the witness has said or done something or has failed to do something, which is consistent with the witness's present testimony.

If you believe that any witness has been so impeached, then it is your exclusive province to give the testimony of that witness such credibility or weight, if any, as you may think it deserves.

Now the rules of evidence provide that if scientific, technical or other specialized knowledge might assist the jury in understanding the evidence or in determining a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education, may testify and state his opinion concerning such matter.

You should consider each expert opinion received in [p. 115-15] evidence in this case and give it such weight as you think it deserves. If you should decide that the opinion of an expert witness is not based upon sufficient education and experience, or if you should conclude that the reasons given in support of the opinion are not sound or that the opinion is outweighed by other evidence, then you may disregard the opinion entirely.

Now the burden is on the plaintiff, that is, Liggett and Myers, in a civil action such as this, to prove every essential element of its claim by a preponderance of the evidence. That's sometimes called the greater weight of the evidence. It means the same thing. Remember the example I gave when the case started about preponderance or greater weight of the evidence? That means that the plaintiff must tip those scales just slightly on its side.

There is another issue in this case that the defendant has the burden of proof on, but I will talk to you about that later in these instructions.

Now a preponderance of the evidence means such evidence as, when considered and compared with that opposed to it, has more convincing force and produces in your minds a belief that what is sought to be proved is more likely true than not. In other words, to establish a claim by the preponderance of the evidence or by the greater weight of the evidence merely means to prove that the claim is more likely [p. 115-16] so than not so.

In determining whether any fact in issue has been proved by a preponderance of the evidence, you may consider the testimony of all the witnesses, all the witnesses, regardless of who may have called them, and all the exhibits received in evidence, regardless of who may have produced them. If the proof should fail to establish any essential element of the plaintiff's claim by a preponderance of the evidence, the jury should find for the defendant as to that claim.

Now there are, generally speaking, two types of evidence from which a jury may properly find the truth as to the facts of the case. One is direct evidence, such as testimony of an eyewitness. The other is indirect or circumstantial evidence, the proof of a chain of circumstances pointing to the existence or non-existence of certain facts. The law makes no distinction between direct or circumstantial evidence, but simply requires that the jury find the facts in accordance with the preponderance of all of the evidence in the case, both direct and circumstantial.

There's an example I sometimes use to illustrate the difference between direct and circumstantial evidence. For example, suppose a mother baked a chocolate cake for dessert, and she left it in the house and went out for a while, and when she came back [sic] she found a big piece of the cake missing. [p. 115-17] And she calls her son, and she says, "Johnny, did you eat the cake I made for supper?" And he says, "No, Mother, I did not eat the cake." Well, suppose his little sister comes running up and says, "Yes, he did, too. I saw him eat the cake." That is direct evidence, the testimony of the sister.

Well, let's suppose there's no little sister around to tell on him, and he denies eating the cake. And his mother says, "Johnny, let me see your hands," and he holds out his hands and there's chocolate on them. And she looks at his lips, and she sees crumbs. Well, she hasn't seen him eat the cake, but she's seen evidence from which she can conclude that he ate the cake. That is circumstantial evidence.

During the course of the trial, I instructed you that some documents and statements were admitted for a limited purpose only and not in some instances for the truth of the statements therein, and you must follow that instruction.

When attorneys for both sides stipulate or agree to a fact, you should accept that stipulation as true and regard the fact to which they have stipulated as proven.

During the trial of this case, certain testimony has been presented to you by way of deposition, consisting of sworn recorded answers to the questions asked of the witness in advance of trial by one or more of the attorneys for the [p. 115-18] parties in the case. Such testimony is entitled to the same consideration and is to be judged

as to credibility and weighed and otherwise considered by the jury, insofar as possible, in the same way as if the witness had been presented and had testified from the witness stand.

Now as you know, there are two primary issues in this case. The first one – well, not necessarily the first one, but the one that I'm going to instruct you on first is the issue under the Robinson-Patman Act, what we have been calling generally the antitrust issue. Then I'm going to give you some instructions on the trademark issue.

[INSTRUCTION NO. 1]*

Now as far as the Robinson-Patman Act claim is concerned, Liggett and Myers contends that Brown and Williamson's volume rebates on its black and white cigarettes in 1984 and 1985 constituted price discrimination in violation of the Robinson-Patman Act, and that it is entitled to damages as a result. On the other hand, Brown and Williamson contends that it did not violate the Robinson-Patman Act and that any loss suffered by Liggett and Myers was due to vigorous competition, changes in consumer demand, or other lawful reasons.

It is my job to inform you what the law is, and it is your job to apply the law to the facts as you see them. First, I'd like to tell you generally what the Robinson-Patman Act provides and what must be shown in order [p. 115-19] for Liggett and Myers to recover any damages.

[*Instruction numbers assigned by the District Court have been inserted by agreement of counsel for the convenience of the Court.]

[INSTRUCTION NO. 2]

As you know, Liggett and Myers contends that Brown and Williamson violated the act in connection with Brown and Williamson's sales of black and white cigarettes in 1984 and 1985.

Now Section 2(a) of the Robinson-Patman Act states, and I'm quoting, "It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchases of commodities of like grade and quality where either or any of the purchases involved in such discrimination are in commerce, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy or prevent competition with any person who either grants or knowingly receives benefit of such discrimination or with customers of either of them."

[INSTRUCTION NO. 3]

In order to establish its claim under the Robinson-Patman Act, Liggett and Myers must prove with respect to a set of compared black and white cigarette purchases each of the following elements by a preponderance or greater weight of the evidence:

One, that at least one of the sales being compared was made across a state line. There's no dispute about that.

Two, that each sale was for use or resale in the [p. 115-20] United States. There's no dispute about that.

Three, that the products sold were physical items. That is undisputed.

Four, that the sales being compared were made by Brown and Williamson at or about the same time. There's no dispute about that.

Five, that the products involved in the sales being compared were of like grade and quality. There's no dispute about that.

Six, that Brown and Williamson charged discriminatory, that is, different net prices to different purchasers in actual sales transactions. There is no dispute that Brown and Williamson charged different prices.

Seven, that there is a reasonable possibility that the discriminatory pricing may harm competition in the cigarette market.

And eight, that Liggett and Myers was injured in its business or property because of Brown and Williamson's discriminatory pricing.

If you find that the evidence is insufficient to prove any one or more of these elements, then you must find for Brown and Williamson and against Liggett and Myers on the Robinson-Patman Act claim.

[INSTRUCTION NO. 4]

Now as I said, six of the eight elements are undisputed, and they need not be considered by you in your [p. 115-21] deliberations. So you are instructed to find, one, that at least one of the sales of Brown and Williamson's black and white cigarettes was made across a

state line. Two, that each pertinent sale of Brown and Williamson's black and white cigarettes was for use and resale in the United States. Three, that the black and white cigarettes sold were physical items. Four, that the black and white cigarette sales being compared were made by Brown and Williamson at about the same time. Five, that the black and white cigarettes involved in the sales being compared were of like grade and quality. And six, that in the sale of the black and white cigarettes Brown and Williamson charged discriminatory, that is, different, net prices to different [sic] purchasers in actual sales transactions.

You shall not consider any of these issues further in determining whether Brown and Williamson violated the Robinson-Patman Act.

[INSTRUCTION NO. 5]

Now Section 2(a) of the Robinson-Patman Act does not make all discrimination in price concerning goods of like grade and quality unlawful. By itself, there's nothing illegal about a company engaging in price discrimination. Rather, a price discrimination within the meaning of Section 2(a) of the Robinson-Patman Act, is merely a price difference and nothing more.

In order for you to find that Liggett and Myers has [p. 115-22] established a claim under the Robinson-Patman Act, Liggett and Myers must show by a preponderance or greater weight of the evidence, one, that Brown and Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market. And two,

that Liggett and Myers was injured in its business or property because of the discriminatory pricing of Brown and Williamson in the sale of black and white cigarettes.

These are the disputed issues in the case which you must decide. If you find that the evidence is insufficient to establish either one of these elements, you must find for Brown and Williamson and against Liggett and Myers.

[INSTRUCTION NO. 6]

Before instructing you further on the disputed issues which you must decide, it is important that you understand what a market and a sub-market is and the importance of these concepts to your consideration of the issues in the case.

Now the outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross elasticity - remember that phrase? - of supply and demand between the product itself and substitutes for it.

Within the broad market, well-defined sub-markets may also exist, which in themselves constitute product markets for antitrust purposes. The boundaries of such [p. 115-23] markets are determined by examining various indicators such as industry or public recognition of the sub-market as a separate economic entity, product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.

All of these factors must be examined in determining whether a well-defined sub-market exists in the broader market. The sub-market test is not merely whether what product can be substituted for the use of another product, but whether products may be reasonably interchanged for the purposes for which they are produced when prices, uses and qualities of these products are considered.

The term "sub-market" is a technical term which depends on the specific factors about which I have instructed you. It does not necessarily have the same meaning as terms you have heard in this trial such as "segment" or "category." The fact that witnesses and lawyers may refer to a "value-for-money segment" does not necessarily have any economic significance and does not establish as such the existence of a sub-market.

I have instructed you that one of the relevant factors in determining whether there is a sub-market in this case is whether the industry or the public recognizes low-priced cigarettes as a separate and distinct economic [p. 115-24] entity. This is only one of the factors you must consider, and you may not find existence of a sub-market based on consideration of this factor alone. Your decision on this question must be based on a consideration of all of the factors which I have just instructed you about.

[INSTRUCTION NO. 7]

Now an example of a market and a sub-market may further your understanding of these economic concepts. For instance, when you shop at the grocery store, lemon products are a separate market, since no other goods

serve the same purposes and uses which lemons do. In the broad lemon market, there are well-defined sub-markets such as fresh – such as the fresh lemon sub-market and the reconstituted lemon juice sub-market.

Although the end use by consumers of fresh lemons and reconstituted lemon juice is often the same, there are important distinctions between the two products such as price, consumer and industry perceptions, packaging, production facilities, quality, distribution and spoilage. Because of these distinctions, despite the similarity in and use – despite the similarity in end use by consumers, fresh lemons and reconstituted lemon juice are different sub-markets of the same broad lemon products market.

Lemons, of course, have nothing to do with this case. They just serve as an example to aid your understanding of what a market and a sub-market is.

[INSTRUCTION NO. 8]

[p. 115-25] Now sub-markets do not exist in every market. For example, 32-ounce soft drink bottles are not a well-defined sub-market of the soft drink bottle market. The reason is that 16 and 64-ounce soft drink bottles are ready substitutes for 32-ounce soft drink bottles. Although size is a unique characteristic of 32-ounce soft drink bottles, few other notable distinctions exist between 32-ounce soft drink bottles and 16 and 64-ounce soft drink bottles since contents, packaging, end use, vendors, consumer and industry perception, and sensitivity to price changes are all the same. Therefore, 32-ounce soft drink bottles are not a well-defined sub-market of the soft drink bottle market.

As with lemons, 32-ounce soft drink bottles have nothing to do with this case. They only serve as an illustration that not all markets have well-defined sub-markets.

[INSTRUCTION NO. 9]

The broad market in which Liggett and Myers claims that Brown and Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition is the market for all cigarettes, branded and price value, in the United States. Neither Liggett and Myers nor Brown and Williamson dispute that the relevant market in which to evaluate a reasonable possibility of injury to competition is all cigarettes.

Liggett and Myers contends that price value [p. 115-26] cigarettes are a well-defined sub-market of the cigarette market. Brown and Williamson disputes this. The term "price value cigarettes" means the generic portion of the cigarette market, and both black and white and branded generic cigarettes are properly included under the price value label.

You must decide two things. Are price value cigarettes a well-defined sub-market of the cigarette market, and was there a reasonable possibility of injury to competition in the cigarette market as a whole due to Brown and Williamson's price value activity. Your answer [sic] to these questions are important, and I will instruct you later how your answers to these questions will affect the evidence you will consider in determining whether Brown and Williamson violated the Robinson-Patman Act.

[INSTRUCTION NO. 10]

Once you have considered the market/sub-market question, you must distinguish between conduct which is lawful competition and conduct which is unlawful competition. Please note that mere diversion of business from one competitor to another competitor or to other competitors is not, in and of itself, unlawful.

The first element you must consider in determining whether Brown and Williamson violated the Robinson-Patman Act is whether Brown and Williamson – is whether Liggett and Myers has shown by a preponderance of the evidence that Brown and Williamson's price discrimination in the sale of black [p. 115-27] and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole.

[INSTRUCTION NO. 11]

By reasonable possibility, I mean just that. It is not necessary for Liggett and Myers to establish that Brown and Williamson's price discrimination actually injured competition. Liggett and Myers need only show that Brown and Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market.

On the other hand, Liggett and Myers must show more than a mere possibility of injury to competition in the cigarette market. There must be a reasonable possibility of injury to competition. Of course, if Liggett and Myers shows that actual injury to competition in the cigarette market occurred due to Brown and Williamson's

price discrimination in the sale of black and white cigarettes, then the reasonable possibility of injury to competition element is satisfied.

[INSTRUCTION NO. 12]

By injury to competition, I mean the injury to consumer welfare which results when a competitor is able to raise and to maintain prices in a market or well-defined sub-market above competitive levels. In order to injure competition in the cigarette market as a whole, Brown and Williamson must be able to create a real possibility of both driving out rivals by loss-creating price cutting, and then holding on to that advantage to recoup losses by raising and [p. 115-28] maintaining prices at higher than competitive levels.

You must remember that the Robinson-Patman Act was designed to protect competition rather than just competitors, and therefore injury to competition does not mean injury to a competitor. Liggett and Myers cannot satisfy this element simply by showing that they were injured by Brown and Williamson's conduct. To satisfy this element, Liggett and Myers must show by a preponderance of the evidence that Brown and Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market, and not just a reasonable possibility of injuring a competitor in the cigarette market.

[INSTRUCTION NO. 13]

Earlier I instructed you whether price value cigarettes are a well-defined sub-market of the cigarette market. Your decision on that question will be very important in determining whether Brown and Williamson's activity had a reasonable possibility of injuring competition in the cigarette market. If you determine that price value cigarettes are a well-defined sub-market of the cigarette market, then as a threshold matter, before examining the injury to competition element of Liggett and Myers' Robinson-Patman Act claim, I charge you that injuring competition in the – I charge you that Brown and Williamson could not have had a reasonable possibility of injuring competition in the cigarette market unless Brown and [p. 115-29] Williamson had market power or a realistic prospect of obtaining market power in either a well-defined price value sub-market or in the cigarette market as a whole.

If you determine that price value cigarettes are not a well-defined sub-market of the cigarette market, then as a threshold matter, before examining the injury to competition element of Liggett and Myers' Robinson-Patman Act claim, I charge you that Brown and Williamson could not have had a reasonable possibility of injuring competition in the cigarette market unless Brown and Williamson had market power or a realistic prospect of obtaining market power in the cigarette market as a whole.

[INSTRUCTION NO. 14]

Now market power must be distinguished from market share. Market share is the percent of sales a company

has in a market or sub-market compared to its competitors. For example, if a company has a 20 percent market share, its competitors have an 80 percent market share.

On the other hand, market power is the power of a company to control prices and to exclude rivals in a market or well-defined sub-market. The power to control prices is simply the ability of a company to establish and to maintain higher price points for its products in a market or well-defined sub-market without suffering a loss of business to its rivals. The power to exclude rivals means the ability of a company to discipline or exclude existing rivals and to [p. 225-30] prevent new rivals from entering the market or well-defined sub-market. If other rivals can with reasonable ease take the place of any excluded or disciplined competitor, then competition cannot be injured in a market or a well-defined sub-market.

[INSTRUCTION NO 15]

For Robinson-Patman Act purposes, market power is the relevant concept you must closely examine. The market share of a company is one factor, but not the only one, which can help you determine whether that company possesses market power. If you find that Brown and Williamson did not possess market power, then you must find for Brown and Williamson and against Liggett and Myers on the Robinson-Patman Act claim. This is because Liggett and Myers cannot demonstrate that Brown and Williamson had a reasonable possibility of injuring competition in the cigarette market unless Brown and Williamson possessed market power.

[INSTRUCTION NO. 16]

Now if you determine that Brown and Williamson possessed sufficient market power, then a reasonable possibility of injuring competition in the cigarette market can be shown in either one of two ways. First, Liggett and Myers may show through market analysis that Brown and Williamson's price discrimination in the sale of black and white cigarettes actually injured competition in the cigarette market. Or two, Liggett and Myers may show that Brown and Williamson had predatory intent from which you may [p. 115-31] infer that Brown and Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole.

[INSTRUCTION NO. 17]

The first way for Liggett and Myers to establish that Brown and Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole is through market analysis. Market analysis is looking at what actually happened in the cigarette market over a relevant time period to determine whether Brown and Williamson's price discrimination in the sale of black and white cigarettes actually injured competition in the cigarette market as a whole.

In making this determination, you should consider whether the cigarette market was more competitive before or after Brown and Williamson's entry into the price value business. In this regard, you may wish to consider changes in cigarette prices as a whole and the

availability of any special promotions as well as the relative price differences between full revenue branded and price value cigarettes.

If you find that Liggett and Myers has established through a preponderance of the evidence, that Brown and Williamson's conduct actually injured competition in the cigarette market, then the reasonable possibility of injury [p. 115-32] to competition element is satisfied and you need not consider whether Brown and Williamson had predatory intent.

[INSTRUCTION NO. 18]

The second way, in addition to market analysis for Brown and Williamson - or for Liggett and Myers to establish that Brown and Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole is through examination of Brown and Williamson's intent when it entered the black and white cigarette business.

Predatory intent, from which a reasonable possibility of injury to competition may be inferred, can be shown in either one of two ways: First, predatory intent may be inferred from proof that Brown and Williamson priced its relevant cigarette product below the reasonably anticipated average variable cost of manufacturing and selling that product over a relevant time period, and/or predatory intent may be found through direct evidence of Brown and Williamson's statements, documents or conduct.

You must remember that no matter what you decide about whether Brown and Williamson possessed predatory intent, you may only infer a reasonable possibility of injury to competition in the cigarette market from predatory intent if you find that Brown and Williamson had sufficient market power.

[INSTRUCTION NO. 19]

Predatory intent is the state of mind in which a [p. 115-33] company plans to discipline and to exclude rivals from a market or a well-defined sub-market so that it can earn higher than competitive profits on its products in that market or well-defined sub-market.

Predatory pricing happens when a company foregoes short-term profits in order to develop a market position such that the company can later raise prices and recoup profits. Predatory pricing differs from healthy competition pricing in its motives. A predator by its pricing seeks to impose losses on other firms, not garner gains for itself. Price reductions that constitute a legitimate competitive response to market conditions are not predatory.

[INSTRUCTION NO. 20]

Now to infer is to make a reasoned, logical conclusion that a disputed fact exists on the basis of another fact which has been shown to exist. The process of drawing inferences from facts in evidence is not a matter of guesswork or speculation. An inference is a deduction or conclusion which you, the jury, are permitted – but not

required – to draw from the facts which have been established by either direct or circumstantial evidence. In drawing inferences, you should exercise your common sense. For example, an inference of decreased competition may be overcome by evidence indicating that competition actually increased.

[INSTRUCTION NO. 21]

If you determine that Brown and Williamson possessed [p. 115-34] market power, the law allows you to infer that Brown and Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market so long as you find that Brown and Williamson acted – at least as long as you find that Brown and Williamson acted with predatory intent. There are two ways that Liggett and Myers can show predatory intent. I will instruct you now on the first way, the average variable cost test.

Earlier I instructed you that you must determine whether price value cigarettes are a well-defined sub-market of the cigarette market. This decision is crucial to your proper application of the average variable cost test. I will explain the average variable cost test to you shortly, but right now you must understand that you cannot apply this test correctly until you determine whether price value cigarettes are a well-defined sub-market of the cigarette market.

If you find that price value cigarettes are a well-defined sub-market of the cigarette market, then, in applying the average variable cost test, you must look at whether Brown and Williamson priced its black and white

cigarettes below reasonably anticipated average variable cost. If you find that Brown and Williamson did price its black and white cigarettes below reasonably anticipated average variable cost, then you may – but need not – infer that Brown and Williamson had predatory intent.

[p. 115-35] On the other hand, if you find that price-value cigarettes are not a well-defined sub-market of the cigarette market, then you should not apply the average variable cost test since there is no evidence that Brown and Williamson priced its full line of cigarettes, branded and price value, below reasonably anticipated average variable cost.

The average variable cost test is a double-inference test, because if you find that Brown and Williamson priced below its reasonably anticipated average variable cost, you may infer that Brown and Williamson had predatory intent, and from predatory intent you may infer that Brown and Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market as a whole.

[INSTRUCTION NO. 22]

Now I would like to take a moment and explain the component parts of the average variable cost test to you. Costs are divided into fixed costs and variable costs.

Fixed costs do not vary with the number of goods that a company produces and sells. Because these costs are incurred regardless of the quantity of products sold, you should not consider fixed costs in determining whether Brown and Williamson's prices were predatory.

Variable costs, on the other hand, are those costs which increase or decrease directly with changes in output. Average variable cost is the sum of all variable costs divided by the total number of units of output in a relevant [p. 115-36] time period. Remember, variable costs, those costs that change directly with a company's output, are the only relevant costs for purposes of the average variable cost test.

The determination of which costs are variable and which are fixed is a matter for you to decide. You should only apply the test if you find that price value cigarettes are a well-defined sub-market of the cigarette market. If so, to apply the test you must determine what Brown and Williamson's average variable cost was for black and white cigarettes and then determine whether the net prices Brown and Williamson charged for its black and white cigarettes were above or below reasonably anticipated average variable cost.

[INSTRUCTION NO. 23]

Once you have determined Brown and Williamson's reasonably anticipated average variable cost, you must decide whether or not Brown and Williamson priced below reasonably anticipated average variable cost. Price here means the net price.

Net price equals list price minus all discounts to the customer. You must remember that customer means the wholesalers and the direct-buying retailers to whom Brown and Williamson directly sold its black and white cigarettes. You should not equate customer with consumer.

[INSTRUCTION NO. 24]

Remember there are several steps that you must go [p. 115-37] through in applying the average variable cost test. Now you've heard testimony from the various experts concerning their figures and their determinations applying the average variable cost test.

If you want to go through the exercise and apply it yourself, first you must decide whether price value cigarettes are a well-defined sub-market of the cigarette market. If you find that price value cigarettes are a well-defined sub-market, then you must decide the total net price of Brown and Williamson's black and white cigarettes. You do this by determining the dollar value of Brown and Williamson's black and white cigarette sales in the United States over a relevant time period. Then you must calculate the reasonably anticipated average variable cost of Brown and Williamson's total black and white cigarette output in the United States.

You calculate this by adding up all of the reasonably anticipated average variable – you calculate this by adding up all of the reasonably anticipated variable costs Brown and Williamson spent in manufacturing and selling black and white cigarettes in the United States over the same relevant time period which you used in deciding Brown and Williamson's total dollar sales. Then you compare your total price figure with your reasonably anticipated average variable cost figure. Only if Brown and Williamson's black [p. 115-38] and white cigarettes are priced below reasonably anticipated average variable cost may you infer predatory intent from this cost price evidence.

If you find that price-value cigarettes are not a well-defined sub-market of the cigarette market, then you must not apply the average variable cost test since there is no evidence that Brown and Williamson priced its full line of cigarettes, branded and price value, below reasonably anticipated average variable cost.

[INSTRUCTION NO. 25]

Liggett and Myers contends that the appropriate time period for determining whether Brown and Williamson priced below its reasonably anticipated average variable cost is the 18-month period from June 1984 through December 1985.

Brown and Williamson, on the other hand, contends that you should look at the entire period from June 1984 to present, or at least from June 1984 through June 1987, to determine whether Brown and Williamson priced below its reasonably anticipated average variable cost.

It is for you to decide what the relevant time period is for determining whether Brown and Williamson priced below its reasonably anticipated average variable cost. In determining the relevant time period, you may use Liggett and Myers' time period or you may use either of Brown and Williamson's time periods, or you may want to arrive at a different time period which you consider relevant.

[p. 115-39] [INSTRUCTION NO. 26]

In determining whether prices are predatory, you must look at what Brown and Williamson reasonably believed its net prices and average variable cost would be. If you find that Brown and Williamson reasonably believed that its average variable cost would not exceed its net prices, but, that for unforeseen reasons, its average variable cost actually did exceed its net prices, then you must find that Brown and Williamson did not price below its reasonably anticipated average variable cost.

[INSTRUCTION NO. 27]

—You must remember that the average variable cost test only creates an inference of predatory intent. Even if you find that Brown and Williamson priced its black and white cigarettes below its reasonably anticipated average variable cost, you may reject the inference of predatory intent. For example, this inference may be rejected if you find that Brown and Williamson was attempting to gain entry into a new portion of the cigarette business and offered net prices below reasonably anticipated average variable cost on an introductory basis only.

[INSTRUCTION NO. 28]

Also, you may, if you wish, reject an inference of predatory intent if you find that a substantial motivation for Brown and Williamson's entry into black and white cigarettes was LIFO decrement avoidance tax benefits.

In your deliberations you should consider, for example, whether Brown and Williamson actually obtained

LIFO [p. 115-40] decrement avoidance tax benefits as a result of selling black and white cigarettes, or whether Brown and Williamson actually considered LIFO decrement avoidance tax benefits when it decided to enter the black and white cigarette business, or whether LIFO decrement avoidance tax benefits were a substantial motivation for Brown and Williamson's entry into black and white cigarettes since Brown and Williamson incurred additional costs, including start-up costs, due to the generic venture which possibility offset the tax savings from LIFO decrement avoidance. Remember that start-up costs often are used for new assets which have a long life, however.

[INSTRUCTION NO. 29]

The second way that Liggett and Myers can establish predatory intent is through direct evidence of Brown and Williamson's statements and conduct. Statements that show predatory intent can be oral or written statements by Brown and Williamson personnel. In determining what weight to give these statements, you may consider whether the person making the statement had a voice in directing Brown and Williamson company policy and whether the person making the statement had direct responsibility for the particular subject matter in question.

Conduct can also indicate predatory intent. For example, if you find that Brown and Williamson knowingly copied Liggett and Myers' quality seal and leaf design, you [p. 115-41] may consider this as some direct

evidence that Brown and Williamson acted with predatory intent. You must determine the weight to give to Brown and Williamson's conduct.

[INSTRUCTION NO. 30]

When you consider direct evidence of predatory intent, you must be very cautious. The true intent of statements and conduct is often difficult to discern. Documentary evidence of predatory intent can be especially misleading and ambiguous, because the exact meaning of words is sometimes unclear and business people often use aggressive words to describe lawful competitive activity.

For instance, I have allowed you to hear some evidence regarding U.S. Tobacco and Georgopulo Company for the limited purpose of providing a yardstick to assist you in evaluating the competitive terminology used in business documents, and evaluating the effectiveness of using lower list prices as a way of competing for consumers at retail, if you find that the experiences of U.S. Tobacco and Georgopulo Company were considered by Brown and Williamson when it made its pricing decisions regarding black and white cigarettes.

You must remember, as I have told you before, there is no contention in this case that Liggett and Myers' conduct with respect to U.S. Tobacco and Georgopulo Company injured competition in the cigarette market. Neither U.S. Tobacco nor Georgopulo Company have any claims against Liggett and Myers in connection with any of the evidence you have heard [p. 115-42] in this case.

[INSTRUCTION NO. 31]

Liggett and Myers must show more than just a reasonable possibility of injury to competition in the cigarette market in order to prove that Brown and Williamson violated the Robinson-Patman Act. The law provides that it must be the price discrimination which causes the reasonable possibility of injury to competition.

In this case, unless Liggett and Myers proves by a preponderance of the evidence that a reasonable possibility of injury to competition in the cigarette market was caused by differences in the prices Brown and Williamson charged for its black and white cigarettes, then Liggett and Myers has failed to carry its burden.

Several examples may be useful here. First, if you find that the reasonable possibility of injury to competition resulted merely from low prices, then you must find that Brown and Williamson's price discrimination did not create any reasonable possibility of injury to competition. Second, if you find that some other aspect of Brown and Williamson's conduct other than price discrimination caused a reasonable possibility of injury to competition in the cigarette market, then you must find that Brown and Williamson's price discrimination did not create a reasonable possibility of injury to competition in the cigarette market.

On the other hand, if you find that price [p. 115-43] discrimination facilitated or made possible predatory conduct by Brown and Williamson, then you may find that it was the price discrimination which had a reasonable possibility of injury to competition in the cigarette market.

Remember, even if you decide that Brown and Williamson's conduct created a reasonable possibility of injury to competition in the cigarette market, you must find for Brown and Williamson and against Liggett and Myers if the conduct which created this threat to competition was something other than Brown and Williamson's price discrimination in the sale of black and white cigarettes.

[INSTRUCTION NO. 32]

If you find that Liggett and Myers has established by a preponderance or greater weight of the evidence, the elements of its claim under the Robinson-Patman Act, that is, you have found that Brown and Williamson's price discrimination had a reasonable possibility of injuring competition in the cigarette market as a whole, then you must find that Brown and Williamson has violated the Robinson-Patman Act, unless Brown and Williamson has established an affirmative defense under Section 2(b) of the Robinson-Patman Act.

Now an affirmative defense is one that Brown and Williamson has the burden of proving by a preponderance of the evidence. Section 2(b) of the Robinson-Patman Act states in general that - and this is a paraphrase - "nothing herein [p. 115-44] contained shall prevent a seller rebutting the evidence by plaintiff indicating a possible violation of the Robinson-Patman Act by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor or the services or facilities furnished by a competitor."

[INSTRUCTION NO. 33]

To establish the affirmative defense of meeting competition, Brown and Williamson must show by a preponderance of the evidence that it lowered its net prices of black and white cigarettes to customers in good faith with the intention to meet but not beat the equally low net price of Liggett and Myers' black and white cigarettes.

Good faith is the most important element of this defense. Good faith is shown if Brown and Williamson reasonably believed, over the relevant time period, that the net prices of its black and white cigarettes were meeting but not beating the equally low net prices of Liggett and Myers' black and white cigarettes.

Even if the net prices of Brown and Williamson's black and white cigarettes were actually lower to customers than Liggett and Myers' net prices, the defense is not lost if Brown and Williamson establishes by a preponderance of the evidence its good faith.

[INSTRUCTION NO. 34]

You must remember that even if all of the elements [p. 115-45] of the Robinson-Patman Act are established, Brown and Williamson has an absolute affirmative defense if it shows that its black and white cigarettes' net prices were set in good faith to meet but not beat the equally low prices of Liggett and Myers' black and white cigarettes. If Brown and Williamson proves the meeting competition defense by a preponderance of the evidence, you must find that Brown and Williamson did not violate the Robinson-Patman Act. Only if you find that Brown

and Williamson is not entitled to the meeting competition defense, may you consider damages.

[INSTRUCTION NO. 35]

If you find that Liggett and Myers has established by a preponderance of the evidence that Brown and Williamson violated Section 2(a) of the Robinson-Patman Act, and if you find that Brown and Williamson has not proven by a preponderance of the evidence the Section 2(b) affirmative defense on meeting competition, then you must consider whether Liggett and Myers is entitled to recover damages.

In order for you to determine that Liggett and Myers is entitled to damages, you must find that Liggett and Myers has proven by a preponderance of the evidence the following: One, that Liggett and Myers was in fact injured in its property or business; two, that Liggett and Myers suffered this injury due to Brown and Williamson's violation of the Robinson-Patman Act; and three, the amount of damages that Liggett and Myers has incurred.

[p. 115-46] [INSTRUCTION NO. 36]

I will now explain each of these elements to you further. Liggett and Myers can establish it was injured in its business or property if, by direct reason of Brown and Williamson's violation of the Robinson-Patman Act, it shows that it suffered financial losses in the period from June 1984 through December 1985, or another shorter time period which you are free to determine. These losses

may include out-of-pocket expenses such as rebates or diminished returns on investment.

[INSTRUCTION NO. 37]

Next, Liggett and Myers must show that Brown and Williamson's price discrimination was a material cause of Liggett and Myers' actual injury. In making this determination, you may consider whether explanations other than Brown and Williamson's price discrimination were the real causes of Liggett and Myers' actual injury. These alternative explanations include, among others, one, competition by other cigarette manufacturers for full revenue branded sales; two, falling consumer demand in the cigarette market; or three, Liggett and Myers' own management shortcomings; or four, loss of consumer sales of black and white cigarettes which Liggett and Myers sold due to more popular branded generic cigarettes which Liggett and Myers did not sell.

You must remember that Liggett and Myers need not prove that Brown and Williamson's price discrimination was [p. 115-47] the sole cause of Liggett and Myers' actual injury, nor must Liggett and Myers show that Brown and Williamson's price discrimination was a more substantial cause of injury than any other.

Liggett and Myers, however, must show that Brown and Williamson's price discrimination played a substantial part in causing Liggett and Myers' actual injury. Therefore, Liggett and Myers may not recover damages if you find that Brown and Williamson's conduct was not a material cause of Liggett and Myers' actual injury.

[INSTRUCTION NO. 38]

Finally, in order for Liggett and Myers to receive damages, it must provide sufficient evidence for you to determine the amount of damages it suffered from Brown and Williamson's illegal conduct. In determining a proper award of damages for Liggett and Myers, you must separate damages to Liggett and Myers from the lawful competitive activities of Brown and Williamson and the other cigarette manufacturers from damage to Liggett and Myers due to Brown and Williamson's illegal activities. Liggett and Myers may only recover damages for the illegal activities of Brown and Williamson.

Once Liggett and Myers has proven that it was, in fact, injured and that Brown and Williamson's conduct was a material cause of its injury, Liggett and Myers' burden of proving the amount of damages is somewhat lightened. You are [p. 115-48] allowed to determine the amount of damages Liggett and Myers incurred based on the evidence which shows the extent of damages as a matter of just and reasonable inference, although the result may be only approximate.

However, this burden is not established by mere speculation and guesswork. Liggett and Myers is still required to put forward substantial and relevant evidence from which damage can be reasonably approximated.

Now you also know that Liggett and Myers has a trademark claim in this case, and Liggett and Myers has been granted three federal trademark registrations for the quality seal from the United States Patent and Trademark Office. These trademark registrations give Liggett and

Myers a legal presumption that the quality seal is a valid trademark, that Liggett and Myers exclusively owns the quality seal and that Liggett and Myers has the exclusive right to use the quality seal in connection with the sale of cigarettes. Defendant has not contested the validity of Liggett and Myers' federal registration and trademark for its quality seal. You are therefore instructed to find that the quality seal was and continued to be a valid protectable trademark as of July 1983, the date set forth in Liggett and Myers' registrations.

Liggett and Myers has also been granted United States trademark registration for its leaf design. Plaintiff

* * *

[p. 115-138] . . . you see, urges it.

I'm just rarely in a position of doing it, and I think it will cut down on numerous questions, although we are going to get some questions - I'll be amazed if we don't - from the jury.

But I have been delayed in getting a clean copy. And, of course, I've had to write in here.

So whether I'll get that to them before 5:00 today, I don't know. But we will see.

Let's get the jury in. Do this. Let them get started. We'll talk about the exhibits. They have all the documentary exhibits available to them now with the turn of a key.

All right, Marshal, if you would, please.

MR. FOSTER: Do I understand, Your Honor, that you are not going to make any change in the trademark instruction?

THE COURT: Right.

MR. FOSTER: All right. Thank you.

THE COURT: I read some more cases on that, too.

(Jury in at 2:15 p.m.)

All right, ladies and gentlemen, I'm going to – sorry that you were delayed, but we are going to be ready here in just minute for you to begin your deliberations.

But we've had some extensive discussions in these [p. 115-139] two perhaps complicated areas of the law, making it easy for you to understand and clarifying anything that I have given.

And I'm going to give you one instruction that I think clarifies the definition of market and sub-market somewhat, and then I'm going to give you another instruction about calculating average variable cost that I had an inadvertent error in it that – particularly when you see the written copy of the charge – could have led you astray. You will probably not notice that much difference in the charge.

But you remember I instructed you about markets and sub-markets and said within the broad market well-defined sub-markets may also exist, which, in themselves, constitute product markets for antitrust purposes.

The boundaries of such sub-markets are determined by examining various indicators such as industry or public recognition of the sub-market as a separate economic entity.

The product's particular characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors – I told you that all of these factors must be examined in determining whether a well-defined sub-market exists in the broader market.

However, I want to point out to you now that the existence of a sub-market or its lack of existence does not require the presence or absence of all of the factors that I [p. 115-140] have just given you.

I said you must examine all of the factors, and then I went on to say the sub-market test is not merely whether one product can be substituted for the use of another product but whether products may be reasonably interchanged for the purpose for which they are produced when prices, uses, and qualities of the product are considered.

Now I also instructed you earlier about – if you wish to make your own calculation of the average variable cost test.

And you have, of course, seen calculations made by the experts, and Mr. Bacon, and others who have testified here in court.

But there are several steps you must go through in applying the average variable cost test, and I'm going to go back through it one more time, having made the change that I missed in the first one – the first time.

First, you must decide whether price value cigarettes are a well-defined sub-market of the cigarette market.

Second, if you find that price value cigarettes are a well-defined sub-market, then you must decide the total net price of Brown and Williamson's black and white cigarettes.

You do this by determining the dollar value of Brown and Williamson's black and white cigarette sales in the [p. 115-141] United States over a relevant time period.

Third, then you must calculate the reasonably anticipated average variable cost of Brown and Williamson's total black and white cigarette output in the United States.

Fourth, you calculate this by adding up all of the reasonably anticipated variable costs Brown and Williamson spent in manufacturing and selling black and white cigarettes in the United States over the same relevant time period which you used in deciding Brown and Williamson's total dollar sales.

Fifth, then you compare your total price figure, as measured by sales over a relevant time period, with your reasonably [sic] anticipated total variable cost figure, as measured over the same relevant time period.

Only if Brown and Williamson's black and white cigarettes are priced below reasonably anticipated average variable cost may you infer predatory intent from this cost pricing evidence.

And sixth, if you find that price value cigarettes are not a well-defined sub-market of the cigarette market, then you must not apply the average variable cost test since there is no evidence that Brown and Williamson

priced its full line of cigarettes, branded and price value, below reasonably anticipated average variable cost.

Now I still intend to send a typewritten copy of [p. 115-142] the entire charge in to you - hopefully this afternoon; if not, first thing in the morning - along with the verdict sheet.

But I am going to ask you now to go in your jury room and begin your deliberations. If anything occurs, please don't leave the jury room but contact the Marshal.

And we will be asking you to come back in at 5:00 o'clock today, assuming you are still deliberating. And we'll be dismissed until 9:30 tomorrow morning.

If you are at a particular point and don't want to come in right on the minute, you can say so.

But, as I said, you are going to be able to go back to your hotels or homes and go about your business.

Just remember, of course, the instructions I've given you about not discussing the case except when the nine of you are together there in the jury room and after you have been checked in court after 9:30 in the morning.

All right, Marshal.

(Jury out at 2:30 p.m.)

THE COURT: All right. I think we had some question about some exhibits. I just want to, you know, point out one more time, in light of the instruction about the market and the sub-market, the reason for it.

You, know, throughout this case Liggett and Myers has claimed that Brown and Williamson's conduct had a . . .

* * *

[p. 123-8] . . . understand the question, if I understand the question.

Here is the question. I'm quoting. Well, the preamble to the question is, quote, "The jury requests more information on market power as some of the instructions are sought - or are sort of unclear to us at this time. Any help would be appreciated."

Now with that premise, we go on to the next paragraph. Please note. They're going to refer to Instruction 18 and Instruction 17, but I think they've got those reversed and I'll tell you why when I read it. I'm quoting now. "On Instruction Number 18, tells us that B&W did not have to have market power." Well, it doesn't tell them that. First, look at 18, the bottom of the page. We're talking about inferring a reasonable possibility of injury to competition in the cigarette market from predatory intent. "If you find that that Brown and Williamson had sufficient market power -" Well, that also ought to be "or a realistic prospect of obtaining market power."

But look at 17. I think when they are saying 18 there, they are talking about 17 because 17 is market analysis and actual injury. If you read the question again on Instruction - they say 18 - if you read it, 17 tells us that B&W did not have to have market power. And then it goes on and says - and on Instruction 17 tells us that

B&W did have to have market power. If you read 17 as 18, the

* * *

[Jury Instructions: Written]

Members of the Jury:

Now that you have heard all of the evidence and the argument of counsel, it becomes my duty to give you the instructions of the Court concerning the law applicable to this case.

It is your duty as jurors to follow the law as I shall state it to you, and to apply that law to the facts as you find them from the evidence in the case. You are not to single out one instruction alone as stating the law, but must consider the instructions as a whole. Neither are you to be concerned with the wisdom of any rule of law stated by me. Regardless of any opinion you may have as to what the law is or ought to be, it would be a violation of your sworn duty to base a verdict upon any view of the law other than that given in the instructions of the Court, just as it would also be a violation of your sworn duty, as judges of the facts, to base a verdict upon anything other than the evidence in the case.

In deciding the facts of this case you must not be swayed by bias or prejudice or favor as to any party. Our system of law does not permit jurors to be governed by prejudice or sympathy or public opinion. Both the parties and the public expect that you will carefully and impartially consider all of the evidence in the case, follow the law as stated by the Court, and reach a just verdict regardless of the consequences.

This case should be considered and decided by you as an action between persons of equal standing in the community, and holding the same or similar stations in life. A corporation is entitled to the same fair trial at your hands as is a private individual. The law is no respecter

of persons, and all persons, including corporations, stand equal before the law and are to be dealt with as equals in a court of justice.

When a corporation is involved, of course, it may act only through natural persons as its agents or employees; and, in general, any agent or employee of a corporation may bind the corporation by his acts and declarations made while acting within the scope of his authority delegated to him by the corporation, or within the scope of his duties as an employee of the corporation.

As stated earlier, it is your duty to determine the facts, and in so doing you must consider only the evidence I have admitted in the case. The term "evidence" includes the sworn testimony of the witnesses and the exhibits admitted in the record.

Remember that any statements, objections or arguments made by the lawyers are not evidence in the case. The function of the lawyers is to point out those things that are most significant or most helpful to their side of the case, and in so doing, to call your attention to certain facts or inferences that might otherwise escape your notice.

In the final analysis, however, it is your own recollection and interpretation of the evidence that controls in the case. What the lawyers say is not binding upon you. Also, during the course of a trial I occasionally make comments to the lawyers, or ask questions of a witness, or admonish a witness concerning the manner in which he should respond to the questions of counsel. Do not assume from anything I may have said that I have any opinion concerning any of the issues in this case. Except for my

instructions to you on the law, you should disregard anything I may have said during the trial in arriving at your own findings as to the facts.

So, while you should consider only the evidence in the case, you are permitted to draw such reasonable inferences from the testimony and exhibits as you feel are justified in the light of common experience. In other words, you may make deductions and reach conclusions which reason and common sense lead you to draw from the facts which have been established by the testimony and evidence in the case.

Now, I have said that you must consider all of the evidence. This does not mean, however, that you must accept all of the evidence as true or accurate.

You are the sole judges of the credibility or "believability" of each witness and the weight to be given to his testimony. In weighing the testimony of a witness you should consider his relationship to the Plaintiff or to the Defendant; his interest, if any, in the outcome of the case; his manner of testifying; his opportunity to observe or acquire knowledge concerning the facts about which he testified; his candor, fairness and intelligence; and the extent to which he has been supported or contradicted by other credible evidence. You may, in short, accept or reject the testimony of any witness in whole or in part.

Also, the weight of the evidence is not necessarily determined by the number of witnesses testifying as to the existence or non-existence of any fact. You may find that the testimony of a smaller number of witnesses as to any fact is more credible than the testimony of a larger number of witnesses to the contrary.

A witness may be discredited or "impeached" by contradictory evidence, by a showing that he testified falsely concerning a material matter, or by evidence that at some other time the witness has said or done something, or has failed to say or do something, which is inconsistent with the witness' present testimony.

If you believe that any witness has been so impeached, then it is your exclusive province to give the testimony of that witness such credibility or weight, if any, as you may think it deserves.

The rules of evidence provide that if scientific, technical, or other specialized knowledge might assist the jury in understanding the evidence or in determining a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify and state his opinion concerning such matters.

You should consider each expert opinion received in evidence in this case and give it such weight as you may think it deserves. If you should decide that the opinion of an expert witness is not based upon sufficient education and experience, or if you should conclude that the reasons given in support of the opinion are not sound, or that the opinion is outweighed by other evidence, then you may disregard the opinion entirely.

The burden is on the Plaintiff in a civil action such as this to prove every essential element of his claim by a "preponderance of the evidence." A preponderance of the evidence means such evidence as, when considered and compared with that opposed to it, has more convincing force and produces in your minds a belief that what is sought to be proved is more likely true than not true. In

other words, to establish a claim by a "preponderance of the evidence" merely means to prove that the claim is more likely so than not so.

In determining whether any fact in issue has been proved by a preponderance of the evidence, the jury may consider the testimony of all the witnesses, regardless of who may have called them, and all the exhibits received in evidence, regardless of who may have produced them. If the proof should fail to establish any essential element of Plaintiff's claim by a preponderance of the evidence, the jury should find for the Defendant as to that claim.

There are, generally speaking, two types of evidence from which a jury may properly find the truth as to the facts of a case. One is direct evidence - such as the testimony of an eyewitness. The other is indirect or circumstantial evidence - the proof of a chain of circumstances pointing to the existence or non-existence of certain facts.

The law makes no distinction between direct or circumstantial evidence, but simply requires that the jury find the facts in accordance with the preponderance of all the evidence in the case, both direct and circumstantial.

The difference between direct and circumstantial evidence can be demonstrated by a simple analogy. Suppose a mother baked a chocolate cake for dessert and she left it in the house and went out for a while, and when she came back she found a big piece of the cake missing. And she calls her son and she says, "Johnny, did you eat the cake I made for supper?" and he says, "No, Mother, I didn't eat the cake." Well, suppose his little sister comes

running up and says: "Yes, he did, too. I saw him eat the cake." Now that is direct evidence.

Well, let's suppose there's no little sister around to tell on him and he denies eating the cake, and the mother says, "Johnny, let me see your hands." And he holds out his hands and there's chocolate on them, and she looks at his lips and she sees crumbs. Well now, she hasn't seen him eat the cake but she's seen evidence from which she can conclude that he ate the cake. That is circumstantial evidence.

Also, during the trial I instructed you that some documents and statements were admitted for a limited purpose only and not, in some instances, for the truth of the statements therein, and you must follow that instruction.

When attorneys on both sides agree or stipulate to a fact, you should accept that stipulation as true, and regard the fact as proven.

During the trial of this case, certain testimony has been presented to you by way of deposition, consisting of sworn recorded answers to question asked of the witness in advance of the trial by one or more of the attorneys for the parties to the case. Such testimony is entitled to the same consideration, and is to be judged as to credibility, and weighed, and otherwise considered by the jury, insofar as possible, in the same way as if the witness had been presented, and had testified from the witness stand.

Of course, the fact that I have given you instructions concerning the issue of Plaintiff's damages should not be

interpreted in any way as an indication that I believe that Plaintiff should, or should not, prevail in this case.

Your verdict must represent the considered judgment of each juror. In order to return a verdict, it is necessary that each juror agree thereto. In other words, your verdict must be unanimous.

It is your duty as jurors to consult with one another and to deliberate with a view to reaching an agreement if you can do so without violence to individual judgment. Each of you must decide the case for yourself, but only after an impartial consideration of all the evidence in the case with your fellow jurors. In the course of your deliberations, do not hesitate to re-examine your own views, and change your opinion, if convinced it is erroneous. But do not surrender your honest conviction as to the weight or effect of the evidence, solely because of the opinion of your fellow jurors, or for the mere purpose of returning a verdict.

Remember at all times you are not partisans. You are judges – judges of the facts. Your sole interest is to seek the truth from the evidence in the case.

Upon retiring to the jury room you should first select one of your number to act as your foreman or forewoman who will preside over your deliberations and will be your spokesman here in court. A form of verdict has been prepared for your convenience.

(Explain verdict)

You will take the verdict form to the jury room and when you have reached unanimous agreement as to your

verdict, you will have your foreman fill it in, date and sign it, and then return to the courtroom.

If, during your deliberations, you should desire to communicate with the Court, please reduce your message or question to writing signed by the foreman or forewoman, and pass the note to the marshal who will bring it to my attention. I will then respond as promptly as possible, either in writing or by having you returned to the courtroom so that I can address you orally. I caution you, however, with regard to any message or question you might send, that you should never state or specify your numerical division at the time.

INSTRUCTION NO. 1

Opening Background

Liggett & Myers contends that Brown & Williamson's volume rebates on its black and white cigarettes in 1984 and 1985 constituted price discrimination in violation of the Robinson-Patman Act and that it is entitled to damages as a result. On the other hand, Brown & Williamson contends that it did not violate the Robinson-Patman Act and that any loss suffered by Liggett & Myers was due to vigorous competition, changes in consumer demand, and other lawful reasons.

It is my job to inform you what the law is and it is your job to apply the law to the facts as you see them. First, I would like to tell you generally what the Robinson-Patman Act provides and what must be shown for Liggett & Myers to recover damages.

INSTRUCTION NO. 2Text of § 2(a)

As you know, Liggett & Myers contends that Brown & Williamson violated the Robinson-Patman Act in connection with Brown & Williamson's sales of black and white cigarettes in 1984 and 1985. Section 2(a) of the Robinson-Patman Act states:

It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, . . . and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them

INSTRUCTION NO. 3Elements of § 2(a)

In order to establish its claim under the Robinson-Patman Act, Liggett & Myers must prove, with respect to a set of compared black and white cigarette purchases, each of the following elements by a preponderance of the evidence:

1. That at least one of the sales being compared was made across a state line;

2. That each sale was for use or resale in the U.S.;
3. That the products sold were physical items;
4. That the sales being compared were made by Brown & Williamson at about the same time;
5. That the products involved in the sales being compared were of like grade and quality;
6. That Brown & Williamson charged discriminatory - that is different - net prices to different purchasers in actual sales transactions;
7. That there is a reasonable possibility that the discriminatory pricing may harm competition in the cigarette market; and
8. That Liggett & Myers was injured in its business or property because of Brown & Williamson's discriminatory pricing.

If you find that the evidence is insufficient to prove any one or more of these elements, then you must find for Brown & Williamson and against Liggett & Myers on the Robinson-Patman Act claim.

INSTRUCTION NO. 4

SUBJECT: Robinson-Patman Act, § 2(a):
Undisputed Elements

Several of the elements of Liggett & Myers' Robinson-Patman Act claim against Brown & Williamson are

undisputed. These undisputed elements shall not be considered by you in your deliberations. You are instructed to find that:

1. At least one of the sales of Brown & Williamson black and white cigarettes was made across a state line;
2. That each pertinent sale of Brown & Williamson black and white cigarettes was for use and resale in the U.S.;
3. That the black and white cigarettes sold were physical items;
4. That the black and white cigarette sales being compared were made by Brown & Williamson at about the same time;
5. That the black and white cigarettes involved in the sales being compared were of like grade and quality; and
6. That, in the sale of black and white cigarettes Brown & Williamson charged discriminatory – that is different – net prices to different purchasers in actual sales transactions.

You shall not consider any of these issues in determining whether Brown & Williamson violated the Robinson-Patman Act.

INSTRUCTION NO. 5

Disputed Elements

Section 2(a) of the Robinson-Patman Act does not make all discriminations in price concerning goods of like grade and quality unlawful. By itself, there is nothing

illegal about a company engaging in price discrimination. Rather, a price discrimination, within the meaning of § 2(a) of the Robinson-Patman Act, is merely a price difference and nothing more.

In order for you to find that Liggett & Myers has established a claim under the Robinson-Patman Act, Liggett & Myers must show by a preponderance of the evidence:

1. That Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market; and
2. That Liggett & Myers was injured in its business or property because of the discriminatory pricing of Brown & Williamson in the sale of black and white cigarettes.

These are the disputed issues in the case which you must decide. If you find that the evidence is insufficient to establish either one of these elements, you must find for Brown & Williamson and against Liggett & Myers.

INSTRUCTION NO. 6

Definition of Market and Submarket

Before instructing you further on the disputed issues which you must decide, it is imperative that you understand what a market and a submarket is and the importance of these concepts to your consideration of the issues in this case.

The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of supply and demand between the product itself and substitutes for it.

Within the broad market, well-defined submarkets may also exist which, in themselves, constitute product markets for antitrust purposes. The boundaries of such submarkets are determined by examining various indicators such as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.

All of these factors must be examined in determining whether a well-defined submarket exists in the broader market. However, the existence of a submarket or its lack of existence does not require the presence or absence of all of the factors. The submarket test is not merely whether one product can be substituted for the use of another product, but whether products may be reasonably interchanged for the purposes for which they are produced when prices, uses, and qualities of the products are considered.

The term "submarket" is a technical term, which depends on the specific factors about which I have instructed you. It does not have the same meaning as terms you may have heard in this trial, such as "segment" or "category." Thus, the fact that witnesses and lawyers may refer to a "value-for-money segment" does not necessarily have any economic significance and does not establish the existence of a submarket.

I have previously instructed you that one of the relevant factors in determining whether there is a submarket in this case is whether the industry or the public recognizes low-priced cigarettes as a separate and distinct economic entity. This is only one of the factors that you must consider, and you may not find the existence of a submarket based upon consideration of this factor alone. Your decision on this question must be based on a consideration of all the economic factors on which I have previously instructed you.

INSTRUCTION NO. 7

Example of Market and Submarket

An example of a market and a submarket may further your understanding of these difficult economic concepts. For instance, when you shop at the grocery store, lemon products are a separate market since no other goods serve the same purposes and uses which lemons do. In the broad lemon market, there are also well-defined submarkets such as the fresh lemon submarket and the reconstituted lemon juice submarket. Although the end use by consumers of fresh lemons and reconstituted lemon juice is often the same, there are important distinctions between the two products such as price, consumer and industry perception, packaging, production facilities, quality, distribution, and spoilage. Because of these distinctions, despite the similarity in end use by consumers, fresh lemons and reconstituted lemon juice are different submarkets of the same broad lemon products market.

Lemons, of course, have nothing to do with this case. They serve just as an example to aid your understanding of what a market and submarket is.

INSTRUCTION NO. 8

Counterexample

Submarkets do not exist in every market. For example, 32 ounce soft drink bottles are not a well-defined submarket of the soft drink bottle market. The reason is that 16 and 64 ounce soft drink bottles are ready substitutes for 32 ounce soft drink bottles. Although size is a unique characteristic of 32 ounce soft drink bottles, few other notable distinctions exist between 32 ounce soft drink bottles and 16 and 64 ounce soft drink bottles since contents, packaging, end use, vendors, consumer and industry perception, and sensitivity to price changes are all the same. Therefore, 32 ounce soft drink bottles are not a well-defined submarket of the soft drink bottle market. As with lemons, 32 ounce soft drink bottles have nothing to do with this case. They only serve as an illustration that not all markets have well-defined submarkets.

INSTRUCTION NO. 9

Relevant Market and Submarkets

The broad market, in which Liggett & Myers claims that Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition, is the market for all cigarettes - branded and price-value - in the United States.

Neither Liggett & Myers nor Brown & Williamson dispute that the relevant market in which to evaluate a reasonable possibility of injury to competition is all cigarettes.

Liggett & Myers contends that price-value cigarettes are a well-defined submarket of the cigarette market. Brown & Williamson disputes this. The term price-value cigarettes means the generic portion of the cigarette market and both black and white and branded generic cigarettes are properly included under the price-value label.

You must decide two things:

1. Are price-value cigarettes a well-defined submarket of the cigarette market?; and
2. Was there a reasonable possibility of injury to competition in the cigarette market as a whole due to Brown & Williamson's price-value activity.

Your answers to these two questions are important. I will instruct you later how your answers to these questions will affect the evidence you will consider in determining whether Brown & Williamson violated the Robinson-Patman Act.

INSTRUCTION NO. 10

Competitive Injury Requirement

Once you have considered the market/submarket questions, you must distinguish between conduct which is lawful competition and conduct which is unlawful competition. Please note that mere diversion of business

from one competitor to other competitors is not in and of itself unlawful.

The first element you must consider in determining whether Brown & Williamson violated the Robinson-Patman Act is whether Liggett & Myers has shown, by a preponderance of the evidence, that Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole.

INSTRUCTION NO. 11

Meaning of Reasonable Possibility

By reasonable possibility I mean just that. It is not necessary for Liggett & Myers to establish that Brown & Williamson's price discrimination actually injured competition. Liggett & Myers need only show that Brown & Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market.

On the other hand, Liggett & Myers must show more than a mere possibility of injury to competition in the cigarette market. There must be a reasonable possibility of injury to competition. Of course, if Liggett & Myers shows that actual injury to competition in the cigarette market occurred due to Brown & Williamson's price discrimination in the sale of black and white cigarettes, then the reasonable possibility of injury to competition element is satisfied.

INSTRUCTION NO. 12

Meaning of Injury to Competition

By injury to competition, I mean the injury to consumer welfare which results when a competitor is able to

raise and to maintain prices in a market or well-defined submarket above competitive levels. In order to injure competition in the cigarette market as a whole, Brown & Williamson must be able to create a real possibility of both driving out rivals by loss-creating price cutting and then holding on to that advantage to recoup losses by raising and maintaining prices at higher than competitive levels.

You must remember that the Robinson-Patman Act was designed to protect competition rather than just competitors and, therefore, injury to competition does not mean injury to a competitor. Liggett & Myers can not satisfy this element simply by showing that they were injured by Brown & Williamson's conduct. To satisfy this element, Liggett & Myers must show, by a preponderance of the evidence, that Brown & Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market and not just a reasonable possibility of injuring a competitor in the cigarette market.

INSTRUCTION NO. 13

Threshold Requirement of Market Power

Earlier I instructed you to determine whether price-value cigarettes are a well-defined submarket of the cigarette market. Your decision on that question will be very important in determining whether Brown & Williamson's activity had a reasonable possibility of injuring competition in the cigarette market.

If you determine that price-value cigarettes are a well-defined submarket of the cigarette market, then as a

threshold matter, before examining the injury to competition element of Liggett & Myers' Robinson-Patman Act claim, I charge you that Brown & Williamson could not have had a reasonable possibility of injuring competition in the cigarette market unless Brown & Williamson had market power, or a realistic prospect of obtaining market power, in either a well-defined price-value submarket or the cigarette market as a whole.

If you determine that price-value cigarettes are not a well-defined submarket of the cigarette market, then as a threshold matter, before examining the injury to competition element of Liggett & Myers' Robinson-Patman Act claim, I charge you that Brown & Williamson could not have had a reasonable possibility of injuring competition in the cigarette market unless Brown & Williamson had market power, or a realistic prospect of obtaining market power, in the cigarette market as a whole.

INSTRUCTION NO. 14

Market Power distinguished from Market Share

Market power must be distinguished from market share. Market share is the percent of sales a company has in a market or submarket compared to its competitors. For example, if a company has a 20% market share its competitors have an 80% market share.

On the other hand, market power is the power of a company to control prices and to exclude rivals in a market or well-defined submarket. The power to control prices is simply the ability of a company to establish and to maintain higher price points for its products in a

market or well-defined submarket without suffering a loss of business to its rivals. The power to exclude rivals means the ability of a company to discipline or exclude existing rivals and to prevent new rivals from entering the market or well-defined submarket. If other rivals can with reasonable ease take the place of any excluded or disciplined competitors, then competition can not be injured in a market or a well-defined submarket.

INSTRUCTION NO. 15

Importance of Market Power

For Robinson-Patman Act purposes, market power is the relevant concept you must closely examine. The market share of a company is one factor – not the only one – which can help you determine whether that company possesses market power. If you find that Brown & Williamson did not possess market power, then you must find for Brown & Williamson and against Liggett & Myers on the Robinson-Patman Act claim. This is because Liggett & Myers can not demonstrate that Brown & Williamson had a reasonable possibility of injuring competition in the cigarette market, unless Brown & Williamson possessed market power.

INSTRUCTION NO. 16

Alternative Methods of Proving Reasonable Possibility of Injury to Competition

If you determine that Brown & Williamson possessed sufficient market power, then a reasonable possibility of

injuring competition in the cigarette market can be shown in either one of two ways:

1. Liggett & Myers may show through market analysis that Brown & Williamson's price discrimination in the sale of black and white cigarettes actually injured competition in the cigarette market; or
2. Liggett & Myers may show that Brown & Williamson had predatory intent, from which you may infer that Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole.

INSTRUCTION NO. 17

Proof of Reasonable Possibility of Injury to Competition through Market Analysis

The first way for Liggett & Myers to establish that Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole is through market analysis. Market analysis is looking at what actually happened in the cigarette market over a relevant time period to determine whether Brown & Williamson's price discrimination in the sale of black and white cigarettes actually injured competition in the cigarette market as a whole.

In making this determination, you should consider whether the cigarette market was more competitive before or after Brown & Williamson's entry into the price-value business. In this regard, you may wish to consider

changes in cigarette prices as a whole and the availability of any special promotions, as well as the relative price differences between full-revenue branded and price-value cigarettes.

If you find that Liggett & Myers has established through a preponderance of the evidence, that Brown & Williamson's conduct actually injured competition in the cigarette market, then the reasonable possibility of injury to competition element is satisfied and you need not consider whether Brown & Williamson had predatory intent.

INSTRUCTION NO. 18

Proof of Reasonable Possibility of Injury to Competition through Predatory Intent

The second way for Liggett & Myers to establish that Brown & Williamson's price discrimination in the sale of black and white cigarettes had a reasonable possibility of injuring competition in the cigarette market as a whole is through an examination of Brown & Williamson's intent when it entered the black and white cigarette business. Predatory intent, from which a reasonable possibility of injury to competition may be inferred, can be shown in either one of two ways:

1. Predatory intent may be inferred from proof that Brown & Williamson priced its relevant cigarette product below the reasonably anticipated average variable cost of manufacturing and selling that product over a relevant time period; and/or

2. Predatory intent may be found through direct evidence of Brown & Williamson's statements, documents or conduct.

You must remember that no matter what you decide about whether Brown & Williamson possessed predatory intent, you may only infer a reasonable possibility of injury to competition in the cigarette market from predatory intent if you find that Brown & Williamson had sufficient market power.

INSTRUCTION NO. 19

Predatory Intent and Predatory Pricing Defined

Predatory intent is the state of mind in which a company plans to discipline and to exclude rivals from a market or a well-defined submarket so that it can earn higher than competitive profits on its products in that market or well-defined submarket.

Predatory pricing happens when a company foregoes short-term profits in order to develop a market position such that the company can later raise prices and recoup profits. Predatory pricing differs from healthy competitive pricing in its motive: a predator by its pricing seeks to impose losses on other firms, not garner gains for itself. Price reductions that constitute a legitimate, competitive response to market conditions are not predatory.

INSTRUCTION NO. 20

Inferences

To infer a fact is to make a reasoned, logical conclusion that a disputed fact exists on the basis of another fact

which has been shown to exist. The process of drawing inferences from facts in evidence is not a matter of guesswork or speculation. An inference is a deduction or conclusion which you, the jury, are permitted – but not required – to draw from the facts which have been established by either direct or circumstantial evidence. In drawing inferences, you should exercise your common sense. For example, an inference of decreased competition may be overcome by evidence indicating that competition actually increased.

INSTRUCTION NO. 21

Average Variable Cost Test

If you determine that Brown & Williamson possessed market power, the law allows you to infer that Brown & Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market as long as you find that Brown & Williamson acted with predatory intent. There are two ways that Liggett & Myers can show predatory intent. I will now instruct you on the first way – the average variable cost test.

Earlier I instructed you that you must determine whether price-value cigarettes are a well-defined submarket of the cigarette market. This decision is crucial to your proper application of the average variable cost test. I will explain the average variable cost test to you shortly. But right now you must understand that you can not apply this test correctly until you determine whether price-value cigarettes are a well-defined submarket of the cigarette market.

If you find that price-value cigarettes are a well-defined submarket of the cigarette market, then, in applying the average variable cost test, you must look at whether Brown & Williamson priced its black and white cigarettes below reasonably anticipated average variable cost. If you find that Brown & Williamson did price its black and white cigarettes below reasonably anticipated average variable cost, then you may – but need not – infer that Brown & Williamson had predatory intent.

On the other hand, if you find that price-value cigarettes are not a well-defined submarket of the cigarette market, then you should not apply the average variable cost test since there is no evidence that Brown & Williamson priced its full line of cigarettes – branded and price-value – below reasonably anticipated average variable cost.

The average variable cost test is a double inference test because if you find that Brown & Williamson priced below its reasonably anticipated average variable cost, you may infer that Brown & Williamson had predatory intent, and from predatory intent, you may infer that Brown & Williamson's conduct had a reasonable possibility of injuring competition in the cigarette market.

INSTRUCTION NO. 22

Definition of Average Variable Costs

Now I would like to take a moment and explain the component parts of the average variable cost test to you. Costs are divided into fixed costs and variable costs.

Fixed costs do not vary with the number of goods that a company produces and sells. Because these costs are incurred regardless of the quantity of product sold, you should not consider fixed costs in deciding whether Brown & Williamson's prices were predatory.

Variable costs, on the other hand, are those costs that increase or decrease directly with changes in output. Average variable cost is the sum of all variable costs divided by the total number of units of output in a relevant time period. Remember variable costs – those costs that change directly with a company's output – are the only relevant costs for purposes of the average variable cost test.

The determination of which costs are variable and which are fixed is a matter for you to decide. You should only apply the test if you find that price-value cigarettes are a well-defined submarket of the cigarette market. If so, to apply the test, you must determine what Brown & Williamson's average variable cost was for black and white cigarettes and then determine whether the net prices Brown & Williamson charged for its black and white cigarettes were above or below reasonably anticipated average variable cost.

INSTRUCTION NO. 23

Definition of Price

Once you have determined Brown & Williamson's reasonably anticipated average variable cost, you must decide whether or not Brown & Williamson priced below

reasonably anticipated average variable cost. Price here means the net price.

Net price equals list price minus all discounts to the customer. You must remember that customer means the wholesalers and the direct buying retailers to whom Brown & Williamson directly sold its black and white cigarettes. You should not equate customer with consumer.

INSTRUCTION NO. 24

Detailed Explanation of Average Variable Cost Calculation

Remember there are several steps you must go through in applying the average variable cost test.

1. You must decide whether price-value cigarettes are a well-defined submarket of the cigarette market.
2. If you find that price-value cigarettes are a well-defined submarket, then you must decide the total net price of Brown & Williamson's black and white cigarettes. You do this by determining the dollar value of Brown & Williamson's black and white cigarette sales in the United States over a relevant time period.
3. Then you must calculate the reasonably anticipated average variable cost of Brown & Williamson's total black and white cigarette output in the U.S..
4. You calculate this by adding up all the reasonably anticipated variable costs Brown &

Williamson spent in manufacturing and selling black and white cigarettes in the United States over the same relevant time period which you used in deciding Brown & Williamson's total dollar sales.

5. Then you compare your total price figure as measured by sales over a relevant time period with your reasonably anticipated total variable cost figure as measured over the same relevant time period. Only if Brown & Williamson's black and white cigarettes are priced below reasonably anticipated average variable cost may you infer predatory intent from this cost-pricing evidence.
6. If you find that price-value cigarettes are not a well-defined submarket of the cigarette market, then you must not apply the average variable cost test since there is no evidence that Brown & Williamson priced its full line of cigarettes – branded and price-value – below reasonably anticipated average variable cost.

INSTRUCTION NO. 25

Relevant Time Period

Liggett & Myers contends that the appropriate time period for determining whether Brown & Williamson priced below its reasonably anticipated average variable cost is the 18-month period from June 1984 through December 1985.

Brown & Williamson, on the other hand, contends that you should look at the entire period from June 1984

to present, or at least from June 1984 through June 1987, to determine whether Brown & Williamson priced below its reasonably anticipated average variable cost.

It is for you to decide what the relevant period of time is for determining whether Brown & Williamson priced below its reasonably anticipated average variable cost. In determining the relevant time period, you may use Liggett & Myers' time period, or you may use either of Brown & Williamson's time periods, or you may arrive at a different time period which you consider relevant.

INSTRUCTION NO. 26

Reasonably Anticipated Average Variable Cost

In determining whether prices are predatory, you must look at what Brown & Williamson reasonably believed its net prices and average variable cost would be. If you find that Brown & Williamson reasonably believed that its average variable cost would not exceed its net prices, but, that for unforeseen reasons, its average variable cost actually did exceed its net prices, but, that for unforeseen reasons, its average variable cost actually did exceed its net prices, then you must find that Brown & Williamson did not price below its reasonably anticipated average variable cost.

INSTRUCTION NO. 27

Possible Justification for Pricing below Average Variable Cost

You must remember that the average variable cost test only creates an inference of predatory intent. Even if

you find that Brown & Williamson priced its black and white cigarettes below its reasonably anticipated average variable cost, you may reject the inference of predatory intent. For example, this inference may be rejected if you find that Brown & Williamson was attempting to gain entry into a new portion of the cigarette business and offered net prices below reasonably anticipated average variable cost on an introductory basis only.

INSTRUCTION NO. 28

LIFO

Also, you may if you wish reject an inference of predatory intent, if you find that a substantial motivation for Brown & Williamson's entry into black and white cigarettes was LIFO decrement avoidance tax benefits.

In your deliberations you should consider, for example:

1. Whether Brown & Williamson actually obtained LIFO decrement avoidance tax benefits as a result of selling black and white cigarettes; or
2. Whether Brown & Williamson actually considered LIFO decrement avoidance tax benefits when it decided to enter the black and white cigarette business; or
3. Whether LIFO decrement avoidance tax benefits were a substantial motivation for Brown & Williamson's entry into black and white cigarettes since Brown & Williamson incurred additional costs, including start-up costs, due to the generic venture which possibly offset the tax savings from LIFO decrement avoidance. Remember that start-up

costs often are used for new assets which have a long life.

INSTRUCTION NO. 29

Direct Evidence of Predatory Intent

The second way that Liggett & Myers can establish predatory intent is through direct evidence of Brown & Williamson's statements and conduct.

Statements that show predatory intent can be oral or written statements by Brown & Williamson personnel. In determining what weight to give these statements, you may consider whether the person making the statement had a voice in directing Brown & Williamson company policy and whether the person making the statement had direct responsibility for the particular subject matter in question.

Conduct can also indicate predatory intent. For example, if you find that Brown & Williamson knowingly copied Liggett & Myers' quality seal and leaf design, you may consider this as some direct evidence that Brown & Williamson acted with predatory intent. You must determine the weight to give to Brown & Williamson's conduct.

INSTRUCTION NO. 30

Caution about Direct Evidence

When you consider direct evidence of predatory intent, you must be very cautious. The true intent of statements and conduct is often difficult to discern. Documentary evidence of predatory intent can be especially

misleading and ambiguous because the exact meaning of words is sometimes unclear and business people often use aggressive words to describe lawful competitive activities.

For instance, I have allowed you to hear some evidence regarding U.S. Tobacco and Georgeopulo Co. for the limited purposes of 1) providing a yardstick to assist you in evaluating the competitive terminology used in business documents; and 2) evaluating the effectiveness of using lower list prices as a way of competing for consumers at retail, if you find that the experiences of U.S. Tobacco and Georgeopulo Co. were considered by Brown & Williamson when it made its pricing decisions regarding black and white cigarettes.

You must remember, as I have told you before, there is no contention in this case that Liggett & Myers' conduct with respect to U.S. Tobacco and Georgeopulo Co. injured competition in the cigarette market. Neither U.S. Tobacco nor Georgeopulo Co. have any claims against Liggett & Myers in connection with any of the evidence you have heard in this case.

INSTRUCTION NO. 31

Causation

Liggett & Myers must show more than just a reasonable possibility of injury to competition in the cigarette market in order to prove that Brown & Williamson violated the Robinson-Patman Act. The law provides that it must be the price discrimination which causes the reasonable possibility of injury to competition.

In this case, unless Liggett & Myers proves by a preponderance of the evidence that a reasonable possibility of injury to competition in the cigarette market was caused by differences in the prices Brown & Williamson charged for its black and white cigarettes, then Liggett & Myers has failed to carry its burden.

Several examples may be useful here. First, if you find that the reasonable possibility of injury to competition resulted merely from low prices, then you must find that Brown & Williamson's price discrimination did not create any reasonable possibility of injury to competition. Second, if you find that some other aspect of Brown & Williamson's conduct other than price discrimination caused a reasonable possibility of injury to competition in the cigarette market, then you must find that Brown & Williamson's price discrimination did not create a reasonable possibility of injury to competition in the cigarette market.

On the other hand, if you find that price discrimination facilitated or made possible predatory conduct by Brown & Williamson, then you may find that it was the price discrimination which caused a reasonable possibility of injury to competition in the cigarette market.

Remember, even if you decide that Brown & Williamson's conduct created a reasonable possibility of injury to competition in the cigarette market, you must find for Brown & Williamson and against Liggett & Myers if the conduct which created this threat to competition was something other than Brown & Williamson's price discrimination in the sale of black and white cigarettes.

INSTRUCTION NO. 32

Robinson-Patman Act, § 2(b)

If you find that Liggett & Myers has established, by a preponderance of the evidence, the elements of its claim under the Robinson-Patman Act, that is you have found that Brown & Williamson's price discrimination had a reasonable possibility of injuring competition in the cigarette market as a whole, then you must find that Brown & Williamson has violated the Robinson-Patman Act unless Brown & Williamson has established an affirmative defense under § 2(b) of the Robinson-Patman Act.

Section 2(b) of the Robinson-Patman Act states that:

... nothing herein contained shall prevent a seller rebutting the (evidence by plaintiff indicating a possible violation of the Robinson-Patman Act) by showing that his lower price or the furnishing of services or facilities to any purchaser or purchasers was made in good faith to meet an equally low price of a competitor, or the services or facilities furnished by a competitor.

An affirmative defense is one that Brown & Williamson has the burden of proving by a preponderance of the evidence.

INSTRUCTION NO. 33

Meeting Competition Defense

To establish the affirmative defense of meeting competition, Brown & Williamson must show, by a preponderance of the evidence, that it lowered its net prices of black and white cigarettes to customers in good faith with

the intention to meet, but not beat, the equally low net prices of Liggett & Myers' black and white cigarettes.

Good faith is the most important element of this defense. Good faith is shown if Brown and Williamson reasonably believed, over the relevant time period, that the net prices of its black and white cigarettes were meeting, but not beating, the equally low net prices of Liggett & Myers' black and white cigarettes.

Even if the net prices of Brown and Williamson's black and white cigarettes were actually lower to customers than Liggett & Myers' net prices, the defense is not lost if Brown & Williamson establishes by a preponderance of the evidence its good faith.

INSTRUCTION NO. 34

Effect of Meeting Competition Defense

You must remember that even if all the elements of the Robinson-Patman Act are established, Brown & Williamson has an absolute affirmative defense if it shows that its black and white cigarettes' net prices were set in good faith to meet, not beat, the equally low net prices of Liggett & Myers' black and white cigarettes. If Brown & Williamson proves the meeting competition defense, by a preponderance of the evidence, you must find that Brown & Williamson did not violate the Robinson-Patman Act. Only, if you find that Brown and Williamson is not entitled to the meeting competition defense, may you consider damages.

INSTRUCTION NO. 35

Damages: General

If you find that Liggett & Myers has established by a preponderance of the evidence that Brown & Williamson violated § 2(a) of the Robinson-Patman Act, and if you find that Brown & Williamson has not proven by a preponderance of the evidence the § 2(b) affirmative defense of meeting competition, then you must consider whether Liggett & Myers is entitled to recover damages.

In order for you to determine that Liggett & Myers is entitled to damages, you must find that Liggett & Myers has proven, by a preponderance of the evidence, the following:

1. That Liggett & Myers was in fact injured in its property or business;
2. That Liggett & Myers suffered this injury due to Brown & Williamson's violation of the Robinson-Patman Act; and
3. The amount of damages that Liggett & Myers has incurred.

I will now explain each of those elements further.

INSTRUCTION NO. 36

Fact of Injury

Liggett & Myers can establish that it was injured in its business or property if, by direct reason of Brown & Williamson's violation of the Robinson-Patman Act, it shows that it suffered financial losses in the period from June 1984 through December 1985 or another shorter time period which you are free to determine. These losses may

include out-of-pocket expenses such as rebates or diminished returns on investment.

INSTRUCTION NO. 37

Antitrust Injury

Next, Liggett & Myers must show that Brown & Williamson's price discrimination was a material cause of Liggett & Myers' actual injury. In making this determination, you may consider whether explanations other than Brown & Williamson's price discrimination were the real causes of Liggett & Myers' actual injury. These alternative explanations include among others:

1. Competition by other cigarette manufacturers for full revenue branded sales; or
2. Falling consumer demand in the cigarette market; or
3. Liggett & Myers own management shortcomings; or
4. Loss of consumer sales of black and white cigarettes which Liggett & Myers sold due to more popular branded generic cigarettes which Liggett & Myers did not sell.

You must remember that Liggett & Myers need not prove that Brown & Williamson's price discrimination was the sole cause of Liggett & Myers' actual injury. Nor must Liggett & Myers show that Brown & Williamson's price discrimination was a more substantial cause of injury than any other.

Liggett & Myers, however, must show that Brown & Williamson's price discrimination played a substantial part in causing Liggett & Myers actual injury. Therefore, Liggett & Myers may not recover damages if you find that Brown and Williamson's conduct was not a material cause of Liggett & Myers actual injury.

INSTRUCTION NO. 38

Amount of Damages

Finally, in order for Liggett & Myers to receive damages, it must provide sufficient evidence for you to determine the amount of damages it suffered from Brown & Williamson's illegal conduct. In determining a proper award of damages for Liggett & Myers, you must separate damage to Liggett & Myers from the lawful competitive activities of Brown & Williamson and the other cigarette manufacturers from damage to Liggett & Myers due to Brown & Williamson's illegal activities. Liggett & Myers may only recover damages for the illegal activities of Brown & Williamson.

Once Liggett & Myers has proven that it was in fact injured and that Brown & Williamson's conduct was a material cause of its injury, Liggett & Myers' burden of proving the amount of damages is somewhat lightened. You are allowed to determine the amount of damages Liggett & Myers incurred based on evidence which shows the extent of damages as a matter of just and reasonable inference, although the result may be only approximate.

However, this burden is not satisfied by mere speculation and guesswork. Liggett & Myers is still required

to put forward substantial and relevant evidence from which damages can be reasonably approximated.

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No. 92-466

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In The
Supreme Court of the United States
October Term, 1992

LIGGETT GROUP INC., now named Brooke Group Ltd.,
Petitioner,
vs.

BROWN & WILLIAMSON TOBACCO CORPORATION,
Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fourth Circuit

BRIEF FOR THE PETITIONER

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QUESTIONS PRESENTED

In a highly concentrated industry with long maintained supracompetitive prices and profits, the jury found that respondent's admitted price discrimination had a reasonable possibility of injuring competition in violation of the Robinson-Patman Act. Substantial evidence showed that respondent succeeded in raising prices, having expressly undertaken to harm consumers by disciplining a price-cutting rival through sustained discriminatory pricing below cost, after an express and accurate analysis of how it would recoup its predatory investment. The Court of Appeals immunized these acts. In its view of "economic logic," such disciplinary pricing was implausible because only a monopolizing or conspiring predator could ever recoup its investment in below-cost disciplinary pricing. The case presents the following questions:

1. Does the Robinson-Patman Act's prohibition of price discrimination that "may substantially lessen competition or tend to create a monopoly . . . or injure . . . competition with [the discriminating seller]" retain independent force or does it address only a monopoly or conspiracy already covered by the Sherman Act?
2. May a court's theoretical speculation about the rational calculations of a hypothetical oligopolist vitiate a jury verdict based on the calculations, conduct, and success of the actual respondent?
3. Even accepting the Court of Appeals' erroneous conclusion that consumers were not injured, must actual injury to consumers -- as distinct from a reasonable threat of injury -- be demonstrated before Robinson-Patman Act liability can be found?

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JURISDICTION

The Supreme Court has jurisdiction pursuant to 28 U.S.C. § 1254(1). The petition for a writ of certiorari was granted on November 16, 1992.

STATUTE INVOLVED

The statutory provision involved in this case is Section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a), reprinted in full at Pet. App. 54a¹, which provides in relevant part:

It shall be unlawful for any person . . . to discriminate in price . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce . . . or injure, destroy, or prevent competition with any person who . . . grants . . . such discrimination . . .

STATEMENT OF CASE

A. Summary

The jury found that price discrimination by respondent-defendant Brown & Williamson Tobacco Corp. ("B&W") had a "reasonable possibility of injuring competition in the cigarette market as a whole" in violation of the Robinson-Patman Act. J.A. 27. The instructions had defined such injury in terms of "loss-creating price cutting" with the "real possibility" that B&W could "recoup" the resulting losses "by raising and maintaining prices at higher than competitive levels" after having disciplined petitioner-plaintiff Liggett

¹ In this brief, Liggett's Petition for a Writ of Certiorari is cited as Pet. App. ____; the Joint Appendix filed simultaneously with this brief is cited as J.A. ____; an exhibit admitted into evidence at trial is cited as PX or DX ____; and the official transcript from the District Court is cited as Tr: (volume)-(page).

Group Inc. ("Liggett").² Instr. No. 12, J.A. 829-30. Substantial evidence showed that

- The cigarette industry is a highly concentrated oligopoly in which supracompetitive prices and profits on so-called full-price or full-revenue ("regular-brand") cigarettes were protected from entry by new firms but were threatened by deeply discounted cigarettes in plain "black-and-white" packages which were introduced in 1980 by Liggett, the smallest of the six oligopolists.
- To discipline Liggett, B&W offered black-and-white cigarettes and sold them for at least 18 months at discriminatory prices that were consistently below their average variable cost and that were not introductory, promotional, or intended in good faith to meet competition.
- These prices were expressly designed to inflict losses upon Liggett that would -- and did -- subsequently force it to raise its black-and-white prices, thereby allowing generic prices to rise more rapidly than regular-brand prices, narrowing the generic discount and extracting higher prices from consumers.
- B&W stated that it would signal its intentions to fellow oligopolists and expressly analyzed their prospective behavior, accurately predicting that some of them would enter the generic segment with the intention -- like that of B&W -- of managing generic prices upwards and narrowing the discount from the regular-brand cigarettes that were the industry mainstay.

² Pursuant to Supreme Court Rule 29.1, petitioner provides the following corporate information. Liggett, now named Brooke Group Ltd., is a publicly owned corporation which holds a controlling interest in New Valley Corporation and MAI Systems Inc. Brooke Group Ltd. has no parent corporation.

- The generic discount did shrink, all prices rose faster than costs or inflation, and B&W expressly took credit for slowing the growth of disruptive generics.

The District Court gave B&W judgment notwithstanding the verdict. The Court of Appeals affirmed on the ground that only an express cartel or prospective monopoly provides sufficient assurance of recoupment to make predatory pricing plausible. (In this brief, the term "predatory pricing" includes, and is used interchangeably with, "disciplinary pricing" that has the purpose or effect of pressuring a rival to behave less competitively -- as, for example, by raising prices.³)

B. Legal Background

In order to reach anticompetitive conduct not already covered by the 1890 Sherman Act, the 1914 Clayton Act condemned certain price discrimination threatening competition between the discriminating seller and its rivals. Such "primary-line" competition continues to be a key concern of that statute as amended by the Robinson-Patman Act in 1936.⁴

This is a primary-line case. Price discrimination is unlawful when its effect "may be substantially to lessen competition or tend to create a monopoly . . . or to injure, destroy, or prevent competition with [the discriminating seller] . . ." 15 U.S.C. § 13(a). According to this Court, there is such an effect when there is a "reasonable

³ B&W's economic experts also defined "predation" this way. J.A. 650, 657. See also Tr. 61: 229-30.

⁴ See *FTC v. Anheuser-Busch, Inc.*, 363 U.S. 536, 544 (1960) ("the legislative history of [the Robinson-Patman] amendments leaves no doubt that Congress was intent upon strengthening the Clayton Act provisions, not weakening them, and that it was no part of Congress' purpose to curtail the pre-existing applicability of § 2(a) to price discriminations affecting primary-line competition.").

possibility" of injuring competition.⁵ The jury was so instructed. Instr. No. 12, J.A. 829.

Through the 1960s, many courts affirmed findings of primary-line injury based upon mere evidence of price discrimination "intended" to injure competition or even competitors.⁶ This Court's decision in *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967), has often been read to endorse this approach, although the Court did emphasize the defendants' below-cost prices. *See infra* p.35.

Since then, lower courts have stated that the required competitive injury may be inferred from (1) an actual worsening of competition in the market or (2) "predatory intent" which may, in turn, be inferred either from express evidence of intention or from pricing below cost. *See infra* note 21. Some courts have also insisted upon an indication that the alleged predator could "recoup" the losses resulting from below-cost pricing. *See infra* pp. 40-41. Recoupment is simply the payoff for below-cost pricing. The recoupment vehicle in most cases and in the standard model is post-predation monopoly for a single firm: A firm voluntarily incurs losses by selling a product for less than its variable cost in order to ruin rivals, gains a monopoly, charges monopoly prices, and earns monopoly profits recouping those earlier losses.

The Fourth Circuit ruled that the standard monopoly model is the only circumstance in which a defendant acting unilaterally would think recoupment likely enough to

⁵ *See Falls City Indus., Inc. v. Vanco Beverage, Inc.*, 460 U.S. 428, 434-35 (1983); *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685, 698, 702 (1967); *Corn Products Refining Co. v. FTC*, 324 U.S. 726, 742 (1945).

⁶ *See generally* F. Rowe, *Price Discrimination Under The Robinson-Patman Act* 149 (1962) ("prevailing legal doctrines hold that predatory price discrimination on the part of a seller designed to destroy the competition of a smaller and weaker rival is *prima facie* illegal under Section 2(a).").

undertake unjustified below-cost pricing injurious to competition. Notwithstanding the different recoupment route described in B&W's own planning documents, the court ruled that an oligopolist's unjustified, below-cost and discriminatory price never has a "reasonable possibility of injuring competition." It so ruled without denying the substantial evidence supporting the jury finding that B&W had in fact engaged in such conduct for the purpose of injuring consumers.⁷

C. Facts

1. The cigarette industry is a highly concentrated oligopoly with supracompetitive prices and profits and high entry barriers. With the leading three firms (Philip Morris, R.J. Reynolds, and B&W) accounting for 82% of sales, the cigarette industry is one of the most highly concentrated oligopolies in the United States. J.A. 352, 495-98, 652, 744-45. Measured by the so-called Herfindahl-Hirschman index, its 1988 concentration of nearly 2800 far exceeds the 1800 level that the Justice Department and Federal Trade Commission regard as "highly concentrated" and thus as presenting a real danger that oligopolists can maintain supracompetitive pricing without any conspiracy.⁸ J.A. 499. The cigarette industry is the textbook example of

⁷ The party against whom a motion for judgment notwithstanding the verdict is made must be given the benefit of every legitimate inference that can be drawn from the evidence. C. Wright & A. Miller, *Federal Practice and Procedure* § 2528 at 563-64 (1971). Instead of dealing with the evidence supporting the jury verdict for Liggett, the Court of Appeals' statement of the case inexplicably emphasized, without context, the evidence most favorable to B&W.

⁸ U.S. Department of Justice and Federal Trade Commission Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104 at § 1.5 (1992). The Herfindahl-Hirschman Index is computed by squaring the shares of each firm and then adding them up — e.g., 1,000 for a market with ten 10% firms.

a stable oligopoly that does not compete on prices;⁹ its history of anticompetitive conduct is well documented.¹⁰

For years cigarette prices have marched upward in lock-step at a rate greater than inflation and cost increases, notwithstanding falling demand. J.A. 500-09, 514-19, 524-26. In classic oligopoly fashion, one company raises its list price and the other five follow immediately. J.A. 501, 429. Prices have increased uniformly twice a year on a regular basis. J.A. 501, 386-89, 404, 425-27. This pattern is so well established that wholesalers raise their resale prices for all manufacturers' cigarettes as soon as one manufacturer increases its price to wholesalers. J.A. 427-29, 440. In the words of B&W's President, "[O]ne key on the cash register rang up all cigarette sales." J.A. 434, 273.

Cigarette profits -- among the highest of any industry -- have long been at supracompetitive levels. J.A. 481-82, 559, 610, 645. Cigarette manufacturers persistently earn profits that are approximately 50% higher than the average for firms in the broader consumer food and related products industry. J.A. 530-33. Despite falling cigarette consumption, U.S. cigarette manufacturers increased their profits per thousand from \$3.80 to \$11.55 between 1980 and 1988. J.A. 748. These high profits have been insulated by high barriers to entry, including the government ban on television advertising. J.A. 560-63, 713. No new firm has successfully entered the industry in decades. J.A. 559-60, Tr. 61:230.

Even B&W's economic experts agreed with Liggett's that the cigarette industry is one of the most highly concentrated (J.A. 652, 741-45, 496); that there has been list price uniformity (J.A. 718, 500-09); that there are high barriers to entry (J.A. 713, 560-63); and that there are high accounting rates of return in the cigarette industry (Tr.

⁹ F. Scherer and D. Ross, *Industrial Market Structure and Economic Performance* 250-251 (3d ed. 1990) (J.A. 748).

¹⁰ *United States v. American Tobacco Co.*, 221 U.S. 106 (1911); *American Tobacco Co. v. United States*, 328 U.S. 781 (1946).

100:221, J.A. 748, 529-31). B&W's expert economist testified that he could think of no explanation consistent with the theory of competition for prices to increase when demand is falling (J.A. 658-59), as happened in the cigarette industry (J.A. 513-25). The Fourth Circuit did not question any of this evidence or the ultimate conclusion that cigarette profits have persisted at supracompetitive levels for a long time.¹¹

2. The oligopoly's supracompetitive profits were threatened by Liggett's deeply discounted black-and-white cigarettes. In 1980, Liggett -- in B&W's words -- "was on the verge of going out of business" and "made the bold

¹¹ The District Court emphasized the testimony of two senior Liggett executives who were asked -- after a series of questions inquiring whether they were engaged in fixing prices with other manufacturers -- whether the industry exhibited anticompetitive "tacit collusion." Both answered in the negative, testifying that prices were "fair" and that the industry was "competitive," especially during the "price war." Tr. 3:170-82, Tr. 11:170-74.

As the authors of a well-known text explain, "business people . . . view competition" not in its economic sense as the rivalry that eliminates supracompetitive prices and profits, but "as the conscious striving against other business firms for patronage." F. Scherer and D. Ross, *Industrial Market Structure and Economic Performance* 16 (3d ed. 1990). One of B&W's economic experts testified that he would not change his conclusion that a market exhibited supracompetitive profits merely because an industry executive testified that profits were fair and reasonable. J.A. 753-54. B&W's other expert economist explained that he did not use the term "tacit collusion" in his classroom because it was too confusing, perhaps because insufficiently distinguished from illegal conspiracies. J.A. 651.

When asked about facts rather than economic conclusions, the Liggett executives testified that the industry does not compete based on price; that all manufacturers increased the price of regular-brand cigarettes the same amount at the same time; and that the industry, not Liggett, set the price for Liggett's regular-brand cigarettes. J.A. 389-91, 396. This pattern resulted in profits that Liggett's President stated "were the biggest of any industry that I have been associated with, very much so." J.A. 392.

move" of introducing a generic cigarette in a plain black-and-white package at a substantial price discount. J.A. 127-28. B&W's senior executives noted in corporate documents that Liggett's move was "the first time that a cigarette manufacturer has used pricing as a strategic marketing weapon in the U.S. since the depression era." J.A. 128.

B&W's own economic expert acknowledged that Liggett's introduction of black-and-whites "demonstrated independence, a breaking away from the pack" and called Liggett a "maverick." J.A. 715. Liggett's black-and-white generics were deeply discounted, originally at list prices -- which, in practice, determine consumer prices -- 30% below regular-brand cigarettes. J.A. 393-94. By 1984, the discount had grown to almost 40% as Liggett declined to raise black-and-white prices on several occasions when prices rose on regular brands. J.A. 66-67, Pet. App. 6a. As a result, by mid-1984 Liggett's black-and-white cigarettes had grown to 4% of the entire cigarette market (J.A. 52), accounting for the bulk of Liggett's volume and for virtually the entire category of discounted cigarettes through at least 1984 (J.A. 73, 81).¹²

¹² This was the case from 1980 until B&W offered its black-and-white generics in mid-1984. (Philip Morris and R.J. Reynolds began offering black-and-whites in 1986 and 1988, respectively -- after B&W had disciplined Liggett).

In April 1984, Reynolds created the "branded generic" category by reducing the list price of its Doral brand to the black-and-white level (and offering a 16 cent rebate to wholesalers purchasing 500 cases quarterly plus, for a time, a 16 cent non-volume rebate -- amounts that never came close to B&W's high-volume rebates of 75 and 80 cents, see *infra* note 15). J.A. 117-18, 327-28. See also *infra* pp. 11-12. Over a year later (and after black-and-white prices began to rise), other manufacturers began to offer branded generics. The list prices of branded generics could more readily be raised than black-and-white prices because they did not bear the inherent discount message of black-and-whites and because they enjoy some brand loyalty. J.A. 108-09. For an account of Liggett's introduction of a so-called "subgeneric" in 1989, see *infra* note 20. →

Consumers and Liggett benefitted from Liggett's price discounting, but as B&W recognized, the other cigarette manufacturers did not. J.A. 82-83. Purchasers of black-and-white cigarettes were not new consumers, but those who previously purchased regular-brand cigarettes. J.A. 132-35, 66. In B&W's words, black-and-white cigarettes "cannibalized" regular-brand cigarette sales and profits. J.A. 107. Liggett was the spoiler threatening the highly profitable price uniformity of the oligopoly. J.A. 565. B&W wrote to its parent company that "the industry's interests -- other than [Liggett's] -- would be far better served had generics never been introduced, they are an immediate and growing threat to all other manufacturers." J.A. 83. According to B&W, "[a]ll other manufacturers face a shrinking industry and eroding share and volume as generics grow." J.A. 83.

B&W was hardest hit. J.A. 132-33. Over 20% of Liggett's generic cigarette consumers had previously patronized B&W brands, even though B&W's share of the cigarette market was 12%. J.A. 128-30. In 1984, B&W calculated that continued growth of black-and-white cigarettes could cost it as much as \$350 million in lost revenue by 1988. J.A. 83.

3. B&W entered the black-and-white segment with an express plan to injure consumers by disciplining Liggett -- a plan from which it never departed. Lest deep discounted cigarettes continue to draw customers away from its brands and force price reductions (or constrain price increases) on regular brands, B&W executives decided in early 1984 to introduce a look-alike black-and-white cigarette with the same list prices as Liggett but with large and

"Generics" originally referred only to black-and-whites (including private label sales) although the term often came to cover the entire discounted category including so-called 25's -- a branded product (*i.e.*, B&W's Richland and Reynolds' Century) in packs of 25 cigarettes at the same price as regular-sized packs of 20. The effective per-cigarette list-price discount was about half (or less) than the discount on black-and-whites. B&W concluded that these "25s are not the answer to generics." Px 7; Tr. 2:199.

discriminatory rebates for wholesalers. J.A. 87-90, 61, 36. B&W did not go into black-and-whites with the objective of making a profit. Rather, it expected to pay rebates that would bring its prices below average variable cost, *see infra* p. 15, predicting that the resulting losses for Liggett would force Liggett to abandon its practice of deepening the list-price discount on generic cigarettes. *See infra* pp. 15-16. The discount had deepened because Liggett was not raising generic prices when regular-brand prices rose. J.A. 66-67. In B&W's words, "Unchallenged, [Liggett] will continue aggressive segment development since it has virtually no stake in the branded, full price market." J.A. 83.

B&W studiously avoided any list-price cuts. Instead, it chose discriminatory rebates to wholesalers as the weapon to inflict losses upon Liggett, paying them retroactively, and thereby "restricting immediate 'pass through' to the trade." ¹³ Px 634; Tr. 32:11. As B&W explained:

The B&W proposal is based on offering greater discounts -- not reducing the list price. Since retail pricing is based on list prices, B&W's generics will not enhance the price/value relationship of present generics. J.A. 99, 57-58.

¹³ True to B&W's predictions, the rebates generally were not passed on. Wholesalers testified that they did not pass on the rebates. Tr. 23: 73-75; Tr. 38:55-57; J.A. 424-25. Liggett, B&W, and Reynolds monitored the price consumers were paying for black-and-whites and observed that the rebates paid wholesalers did not affect the consumer price. J.A. 239 (B&W); Tr. 39:227-28 (Liggett); Tr. 105: 64-65 (Reynolds).

Of course, even if rebates had been passed on to retailers and thence to consumers, B&W's scheme would nonetheless have been predatory. Black-and-white volume would have expanded temporarily, and thereby increased the rebate burden on Liggett as well as on B&W. Whether kept by wholesalers or ultimately received by consumers, the below-cost rebates had the purpose and effect of bringing higher prices later.

B&W's goal was *first*, in its own words, to "prevent[] an increase in the percentage pricing spread between generic and branded cigarettes" and then to "gradually reduce[]" that spread." J.A. 70-72, 280. B&W expressly stated that it wanted to "manage down" demand for the very product it was introducing. J.A. 108-09. It was determined to avoid any action that would "create new consumer demand" or "accelerate segment growth." J.A. 57-58, 87-88. B&W expressly saw "no need to promote or advertise heavily to the consumer" because, rather than attract consumers to a new product, "we [B&W] would be seeking to displace Liggett" at the wholesale level in order to "gradually reduc[e the] percent difference between generics and full revenue brands" and thereby "slow our branded, higher margin losses to generics." J.A. 279, 113-15. This was its persistent objective. J.A. 70-71, 257, 279-80.

Predicting that some of the other oligopolists would enter the discounted segment, B&W analyzed their prospective reactions and concluded that they too would seek to shrink the discount. *See infra* pp. 16-18. As the consumer price of generics increased relative to those of regular brands, B&W reasoned, fewer consumers would be willing to "trade off image for price," and the cannibalization of regular brands would decline or at least not grow as rapidly. J.A. 72, 67-70.

In April-May 1984, B&W revisited -- but did not revise -- its plan when R.J. Reynolds ("RJR"), a larger competitor, lowered the list price of its existing Doral brand to generic levels and offered a small rebate. *See supra* note 12. Though anticipated by B&W, Reynolds' move confirmed B&W's realization that it could not prevent all growth of the generic segment. J.A. 75, 84-85, 141. Nevertheless, B&W reasoned that RJR's objective was consistent with its own; both before and after Doral's repositioning, B&W identified RJR's "Priority One" as

[l]aunch[ing] a generic product line to gain control of and contain generic segment growth. RJR would strive to limit segment development since incremental generic growth will disproportionately

reduce RJR's total margins. J.A. 84 (before Doral), J.A. 164 (after Doral).

Even so, B&W concluded that its pre-existing program to "offer an equivalent line of generics to [Liggett] at the same list price but at lower net price" to wholesalers provided the "*best opportunity to contain cannibalization of its full revenue branded products and limit segment growth.*" J.A. 112, 114 (emphasis in original). It deemed entry for that purpose "imperative." J.A. 141. It continued to state its objective to be "to displace L&M as the supplier of black and white/private label generics," and repeatedly confirmed that its "plan of action to be followed is exactly as our previous proposal outlined." J.A. 121.

The following year, B&W again reaffirmed its goal to "manage segment growth and profitability by gradually reducing [the] percent difference between generic and full revenue brands." J.A. 279, 280, 257. By April 1985, B&W saw progress toward achieving its goal: "B&W's presence within the segment appears to have resulted in reduced consumer advertising by L&M and a slowing in the segment's growth rate." J.A. 257.

4. Price discrimination was integral to B&W's plan. According to B&W's own strategic documents, price discrimination was crucial. J.A. 58, 88-89. B&W believed that discriminatory rebates could discipline Liggett at least cost to B&W because they would "[a]chieve maximum desired volume through a minimum number" of wholesalers, thus reducing B&W's investment in its anticompetitive scheme. J.A. 50, 402-03. As B&W explained (in a textbook account of how discrimination aids predation), discriminatory rebates are "the most cost efficient and effective means" of achieving its goal. J.A. 69.

B&W began to implement its plan in June 1984, initially approaching a "hit list" of Liggett's 14 largest wholesalers, offering them unprecedentedly large rebates for purchases of 1000 or 1500 cases of black and whites per quarter -- a volume which only the very largest wholesalers could ever

achieve and which were therefore discriminatory.¹⁴ J.A. 168-69, 174, 412-13. When Liggett responded, though with lesser rebates than B&W's, B&W increased its rebates still further,¹⁵ as it had anticipated it would (J.A. 73-75, 91-92, Px 291; Tr. 27:40), and added a special discriminatory inducement to the few super-buyers of more than 8000 cases per quarter (J.A. 328).

5. B&W priced its black-and-whites below their average variable cost. From the date of its first shipment in July 1984 and for the next 17 months through the end of 1985, B&W's net price to wholesalers was 30 cents per carton below its average variable cost. J.A. 339. As B&W's own expert economist conceded, B&W in fact engaged in sustained below-average-variable-cost pricing for 18 months:

¹⁴ *FTC v. Morton Salt*, 334 U.S. 37, 42-44 (1948). B&W conceded that its larger discounts were available only to a few, Tr. 46:89, and B&W did not appeal the trial judge's ruling that its different prices were in fact discriminatory. B&W initially offered rebates of 20 cents per carton for customers buying at least 500 cases quarterly, 25 cents for customers buying at least 1000 cases, and 30 cents for those buying at least 1500 cases. J.A. 178-79, 327-28. B&W's per carton payments applied to all B&W black-and-white cigarettes purchased, not just the incremental purchases above the volume threshold, creating a strong inducement for a wholesaler to shift all its generic business to B&W rather than splitting its business between B&W and Liggett. J.A. 70, 180. Prior to B&W's initial offer, Liggett's highest volume offer was 13 cents for purchases above 500 cases per quarter and was conditioned on specified promotional activity. J.A. 179-80, 327, 411-12, Px 15 at 098508; Tr. 2:199. Indeed, prior to B&W's offer, no cigarette manufacturer had ever based a rebate or discount on a quarterly purchase volume nearly as large as 1500 cases. J.A. 413.

¹⁵ J.A. 420-21. For example, when Liggett came within 10 cents per carton of B&W rebates for higher volume purchasers, B&W increased its rebates 30 cents above Liggett's. J.A. 327-28. By July 1984, when B&W made its first generic shipment, its rebates were 75 cents for buyers of 1500 cases quarterly and 80 cents for the few wholesalers buying 8000 cases quarterly. J.A. 327-28.

- Q. Did B&W price above or below average variable costs in 1984 and 1985?
- A. Pre-tax trading profit was negative. Therefore, if you disregard financial consequences other than direct sales revenue [i.e. reduced taxes on regular-brand cigarette profits] in what you refer to as price the answer would be that prices are below average variable cost.¹⁶ J.A. 651.

This was no accident. Even before its entry, B&W's documents had expressed a willingness to spend its "full variable margin" on generic rebates. J.A. 68, 89-90. B&W's controller admitted that if B&W sacrificed full variable margin, it necessarily would have a negative trading profit (Tr. 98:99) which, as established in the testimony quoted above, meant below-average-variable-cost pricing. See also J.A. 664-66.

Nor were these below-cost prices merely introductory. B&W's senior sales manager testified that B&W's volume rebates were not an "introductory allowance." Tr. 91:42. Introductory offers to wholesalers in the cigarette business customarily last four to six weeks. J.A. 411, 416, Tr. 39:171. B&W's initial below-cost rebate offers were for one year, and were subsequently extended even after B&W had achieved its 1984 volume goals. J.A. 197, 478, 192.

¹⁶ Because B&W's losses on generics partially offset company profits gained from other sales -- whether from branded cigarettes or other products -- and therefore reduced B&W's federal income taxes, it unsuccessfully urged the court and jury to count such tax savings (and other alleged income tax savings) as if they were generic revenue, which could then be presented as exceeding variable costs. See *Liggett Group Inc. v. Brown & Williamson Tobacco Corp.*, 1989-1 Trade Cas. (CCH) ¶ 68,583 (1988) at 61,107-08 ("B&W's argument for consideration of tax savings on profits generated on other products appears to be at odds with the stated goal of the average-variable-cost test. . . . This court has found no case law or legal literature that supports B&W's position.").

6. B&W's market analysis correctly predicted that Liggett would be disciplined notwithstanding parental assets and continued profits on regular-brand cigarettes. B&W carefully analyzed whether it could succeed in forcing Liggett to raise list prices on black-and-whites and thereby shrink the discount. It knew, of course, that Liggett would continue to earn profits on its regular brands, and that Liggett's parent company had considerable assets. But it also knew that the parent was trying to sell Liggett and would not tolerate sustained losses on generics. J.A. 200, 253, 74, 92. B&W wrote that "it is unlikely that [Liggett] can, in fact, be prepared to engage in a sustained battle . . ." J.A. 97.

B&W believed that in just the six months after B&W entered, Liggett would suffer "\$35-45 [million] in lost variable margin to defend its business. . ." J.A. 91. Accordingly, it projected that Liggett "will probably attempt to raise prices as soon as possible," (J.A. 200) and that "Liggett will try to survive by: raising prices on generics" (J.A. 253). B&W knew that the losses it inflicted upon Liggett could be reduced only by Liggett raising list prices. Liggett could not cut its rebates without forfeiting its generic business.¹⁷ J.A. 469-70. Such a forfeit was inconceivable, for B&W recognized that "[w]ithout generics, L&M's tobacco business would be irreparably damaged." J.A. 73. Thus, B&W wrote, "L&M can be expected to minimally match" B&W rebates. J.A. 91. As one Liggett executive testified, "It was a lose/lose situation for us. If we didn't pay the incentives [volume rebates] we lost the volume. If we paid the incentives, it took a tremendous amount of money

¹⁷ Cutting list prices rather than following B&W in offering higher rebates was also unlikely for Liggett. As B&W wrote, "A reduction in list price by L&M is highly unlikely due to the resulting reduction of wholesaler profits" that would induce wholesalers to substitute B&W's look-alike black-and-whites for Liggett's. J.A. 171.

that we really couldn't afford. So it was lose/lose either way we went."¹⁸ J.A. 468.

True to its prediction, B&W succeeded in disciplining Liggett. Liggett spent tens of millions responding to B&W's below-cost, discriminatory rebates to wholesalers. Tr. 39:232-35, 37:93-104. By June, 1985, Liggett made its initial surrender in the form, as B&W had predicted (J.A. 252-53), of raising its generic list price, leading to higher consumer prices. J.A. 325. A few months later, B&W matched this move.¹⁹ In December 1985, Liggett resisted B&W's attempt to lead another price increase. However, in June 1986, December 1987, and June 1988, a disciplined Liggett followed B&W's black-and-white price increases. J.A. 295-302, 304-07. As a result, black-and-white prices, which then constituted the bulk of all generic cigarettes, rose at a faster rate than regular-brand cigarettes, narrowing the discount gap. J.A. 325, 326.

7. B&W's market analysis correctly predicted that fellow oligopolists would enter the discounted cigarette segment but would narrow the discount after Liggett was disciplined. B&W wrote, "Someone must put a lid on L&M -- if we do -- does someone else need to?" J.A. 61. Though doubtless preferring that one of the larger oligopolists "put a

¹⁸ B&W also calculated that to the extent it could put Liggett on the defensive and "force them to defend their current business," Liggett would have fewer resources "available to support further business-building" in the generic segment. J.A. 114-15.

¹⁹ The delay was designed to increase B&W volume so that it would be in a stronger position to manage black-and-white prices upward. B&W had explained in April 1985 that it was not yet "in a position to lead a price increase." J.A. 263. It correctly anticipated that Liggett "because of margin erosion will initiate a price increase on the order of \$1.50 per [thousand] around mid-year, 1985." J.A. 263. B&W would wait for a few months to generate volume and then "initiate a price increase of \$2.50," which Liggett would follow -- "again because of margin erosion." J.A. 263. See also J.A. 242.

lid" on Liggett, B&W concluded in its high level planning documents that the larger firms would refrain from disciplinary conduct toward Liggett for fear of antitrust liability. J.A. 76, 93. As for itself, B&W estimated how much it could save by disciplining Liggett. J.A. 83. Its unilateral investment in below-average-variable-cost pricing turned out to be \$14.9 million (J.A. 338, Tr. 49:55), which is far less than the \$350 million that it estimated it would forego by 1988 unless the growth of generics were slowed down (J.A. 83).

B&W considered the likely reactions of the other oligopolists and concluded that they would not interfere with its effort to narrow the discount gap. B&W reasoned (1) that they would not forsake the industry's long-standing oligopoly pricing (J.A. 131-32) and (2) that they had no incentive or desire to keep prices as low as Liggett at the expense of their very large market shares of regular-brand cigarettes (J.A. 83).

B&W's plan did not depend on the assumption that other manufacturers would remain on "the sidelines." To the contrary, B&W forecast that they might enter in order to "gain control of and contain generic segment growth." J.A. 84. B&W's post-Doral "Strategic Conclusions" discussed two options for the other manufacturers -- remaining on the sidelines versus entering the generic segment -- and concluded:

The latter appears to be the most predictable approach. . . . It is quite likely that manufacturers will introduce branded generics, develop loyal franchises and then gradually raise prices over the longer term. J.A. 132.

In particular, B&W predicted that industry leader Philip Morris "will not take a leadership position in low margin brand marketing." J.A. 249. And R.J. Reynolds "would strive to limit the [generic] segment development since incremental generic growth will disproportionately reduce RJR's total margins." J.A. 84.

To ensure this result, B&W also wrote that it would "signal [its] intent to competition" that its entry and rebates would "not expand [the] segment." J.A. 61. Its discriminatory rebates to wholesalers had that effect, because they did not generally lead to lower consumer prices. *See supra* p. 10. The other manufacturers did not misread B&W's intentions. No one interfered with B&W's efforts to discipline Liggett. When B&W entered black-and-whites in mid-1984, no one else entered the so-called rebate war -- for example, Reynolds did not adjust the rebates it was offering on its Doral brand. Tr. 105: 64-65. And most importantly, all cigarette prices rose along with rising black-and-white prices. J.A. 326.

8. The discount shrank, all prices rose and B&W concluded that its plan succeeded. As B&W intended, the list-price differential between generic and regular-brand cigarettes declined from almost 40% in 1985 to 26.8% in 1989.²⁰ Pet. App. 6a, J.A. 325-26. A Reynolds executive testified that, by 1987, the industry was managing generic prices and profitability upward. J.A. 758-59. By the time of trial in 1989, the prices of both regular-brand cigarettes and generics had increased dramatically in classic oligopolistic fashion (J.A. 326), greatly outstripping increased promotional activities such as retail couponing, known as "stickering" (J.A. 509-10). Although price-discounted brand-name cigarettes (branded generics) accounted for 10.66% of the cigarette market by the end of 1989, they obviously did not provide an effective brake on increasing

²⁰ Consumer prices reflect manufacturer list prices. J.A. 99-100. Consumers thus lost the benefit of the larger discount during at least 1986, 1987 and 1988. In December 1988, Liggett introduced a new "subgeneric" brand, Pyramid, with a list price approximately 50% below regular brands; two other manufacturers responded with competing entries. J.A. 326. At the time of trial in 1989, subgeneric sales ("third price point") were less than 1% of all cigarette sales. Dx 8888 at 2, 12; Tr. 108:143. Liggett thus was able to reintroduce some measure of price competition at a time when renewed predation was unlikely in view of the District Court's denial of B&W's motion for summary judgment.

cigarette prices. *See* J.A. 326. In 1988, black-and-white and branded-generic prices were higher than regular-brand prices had been at the time B&W entered the generic segment -- a phenomenon that cannot be attributed to increased costs or inflation. J.A. 748, 514-25. Indeed, one year after entering the generic segment B&W informed its parent corporation that its strategy apparently had succeeded in "a slowing in the segment's growth rate." J.A. 257.

D. Proceedings Below

1. **Jury Instructions and verdict.** The jury was instructed that B&W had engaged in price discrimination in the sale of its black-and-white generic cigarettes. Instr. No. 4, J.A. 824. It was asked to decide whether that price discrimination had a reasonable possibility of injuring competition in the cigarette market as a whole. J.A. 27-28. Instr. No. 5, J.A. 823.

In accord with Robinson-Patman Act precedent,²¹ the jury was instructed that a reasonable possibility of competitive injury could be inferred either from (1) "market analysis that Brown & Williamson's price discrimination in the sale of black-and-white cigarettes actually injured competition in the cigarette market" or from (2) "predatory intent" that in turn could be inferred either from (a) below-average-variable-cost pricing or from (b) "direct evidence of Brown & Williamson's statements, documents, or conduct." Instr. Nos. 16 and 18, J.A. 832, 834.

²¹ *Double H Plastics, Inc. v. Sonoco Prods. Co.*, 732 F.2d 351, 354 (3d Cir.), *cert. denied*, 469 U.S. 900 (1984); *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340, 347 (3d Cir. 1981), *cert. denied*, 455 U.S. 1017 (1982); *D.E. Rogers Assoc., Inc. v. Gardner-Denver Co.*, 718 F.2d 1431, 1439 (6th Cir. 1983), *cert. denied*, 467 U.S. 1242 (1984); *Lomar Wholesale Grocery, Inc. v. Dieter's Gourmet Foods, Inc.*, 824 F.2d 582, 596 (8th Cir. 1987), *cert. denied*, 484 U.S. 1010 (1988); *Henry v. Chloride, Inc.*, 809 F.2d 1334, 1344 (8th Cir. 1987). *See also* *Pacific Engineering & Prod. Co. v. Kerr-McGee Corp.*, 551 F.2d 790, 798 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977).

Predatory intent was carefully defined. The jury was told that the only intent relevant to this case would be a B&W plan "to discipline and exclude . . . rivals . . . so that it can earn higher than competitive profits. . . ." Instr. No. 19, J.A. 835. Moreover, the fact to be inferred from predatory intent -- that is, "a reasonable possibility of competitive injury" -- was explicitly defined in terms of "loss-creating price cutting" with the "real possibility" of "recoup[ing] losses by raising and maintaining prices at higher than competitive levels." Instr. No. 12, J.A. 829. The jury was warned not to infer injury to competition from predatory intent if its common sense indicated that there was no such possibility of recoupment.²² Instr. Nos. 20 and 12, J.A. 835, 829.

The jury was further instructed that "[i]f you find that Brown & Williamson reasonably believed that its average variable cost would not exceed its net prices, but, that for unforeseen reasons, its average variable cost actually did exceed its net prices, then you must find that Brown & Williamson did not price below its reasonably anticipated average variable cost." Instr. No. 26, J.A. 841. Nor was any inference of injury to competition permitted to be drawn from below-average-variable-cost pricing if B&W was "attempting to gain entry into a new portion of the cigarette business and offered net prices below reasonably anticipated average variable cost on an introductory basis only." Instr. No. 27, J.A. 841. Furthermore, the jury was told B&W lawfully could price its black-and-white cigarettes below average variable cost if it was engaged in a "good faith"

²² The jury also was cautioned that "mere diversion of business from one competitor" is not unlawful, and that "the Robinson-Patman Act was designed to protect 'consumer welfare' rather than just competitors." Instr. Nos. 10 and 12, J.A. 828, 829. As an additional burden on Liggett, the instructions required it to show that B&W possessed some measure of "market power" in either the whole cigarette market or in a well-recognized submarket, if any, for generic cigarettes. Instr. Nos. 13 and 15, J.A. 830, 832. In all events, the instructions made clear that B&W was liable only if it threatened competition in the whole cigarette market. Instr. No. 12, J.A. 829.

effort to "meet competition."²³ Instr. Nos. 33 and 34, J.A. 846-847.

The jury returned a verdict for Liggett.

2. **JNOV decision.** The District Court granted B&W judgment notwithstanding the verdict. The District Court found that the evidence of B&W's anticompetitive purpose was "more voluminous and detailed than any other reported case," revealing an intent to harm both Liggett and consumers. Pet. App. 31a. Nevertheless, the court held that B&W "could not have had a reasonable possibility of injuring competition" because there was no "economically plausible way to recoup its losses." Pet. App. 32a. The District Court did not challenge the possibility of recoupment in an oligopoly setting. Rather, it declined to credit the detailed economic evidence that profits were supracompetitive, because Liggett's executives had denied "tacit collusion" and had testified that cigarette profits were not "excessive." Pet. App. 34a-35a. See *supra* note 11. The District Court reasoned that without supracompetitive profits, disciplining

²³ The jury was also instructed that "if you find that the reasonable possibility of injury to competition resulted merely from low prices, then you must find that Brown & Williamson's price discrimination did not create any reasonable possibility of injury to competition." Instr. No. 31, J.A. 844. To find for Liggett, the jury had to find that "price discrimination facilitated or made possible predatory conduct by Brown & Williamson." Instr. No. 31, J.A. 844.

Finally, the jury was instructed it could not award damages to Liggett unless it found that Liggett "was in fact injured in its property or business" as a result of B&W's violation of the Robinson-Patman Act. Instr. No. 35, J.A. 848. Specifically, the jury was told to consider whether Liggett was injured by B&W's below-cost price discrimination rather than by "competition by other cigarette manufacturers, falling demand for cigarettes" or "Liggett & Myers' own management shortcomings." Instr. No. 37, J.A. 849. In determining the amount of damages the jury was required to "separate damages to Liggett & Myers from the lawful competitive activities of Brown & Williamson and the other cigarette manufacturers. . . ." Instr. No. 38, J.A. 850.

Liggett would merely cause B&W to lose money without ever achieving a payoff. The District Court also declined to credit the evidence that the larger cigarette oligopolists shared B&W's interest in stabilizing and then narrowing the gap between regular-brand and generic cigarettes and in preserving supracompetitive regular-brand profits. Pet. App. 36a.²⁴

The District Court stated that its *inovo* decision was "based upon interpretations of the applicable law" rather than upon any quarrel with the evidence or instructions. Pet. App. 19a note 6. It said that no new trial would be necessary -- and thus that judgment should be given on the jury verdict -- if "an appellate court applied legal standards more favorable to Liggett." Pet. App. 19a note 6.

3. **Court of Appeals decision.** The Fourth Circuit affirmed, though by different reasoning. It ruled that recoupment by an oligopolist is never a realistic possibility. Without denying the factual basis for the jury's conclusion that B&W acted predatorily to discipline Liggett and injure consumers, the court ruled as a matter of law that it would be irrational for an oligopolist to act in this way. According to the court's "economic logic," only a monopolist (actual or prospective) or a member of an organized cartel could ultimately profit from charging below-cost prices to discipline a rival: An oligopolist's below-cost investment in disciplinary pricing could never pay off because fellow oligopolists would never be "certain" that the predator was disciplining a maverick rather than attempting to expand its own market share. Pet. App. 11a. According to the Fourth Circuit, the other oligopolists would be more likely to respond

²⁴ In addition, the District Court held that (i) because all B&W black-and-white prices were below their costs such that the high price did not subsidize the low price, the difference between those prices (the "discrimination") did not "cause" any injury to competition that may have occurred (Pet. App. 38a-42a) and, in any event, (ii) B&W's below-cost prices on generics were irrelevant and could not cause "antitrust injury" because they were offset by profits on regular-brand product (Pet. App. 42a-49a).

competitively, undermining oligopolistic price discipline. Pet. App. 12a. The Fourth Circuit believed that its "theoretical suspicions" were confirmed in "hindsight" by the growth of the generic sector, Pet. App. 12a, notwithstanding the reduced generic discount and higher prices for both generic and regular-brand cigarettes. Pet. App. 6a.

SUMMARY OF ARGUMENT

The decision below rests on two fundamental errors of law. *First*, the Fourth Circuit erroneously limited the Robinson-Patman Act to monopoly or cartel cases, thus making it redundant of the Sherman Act. But the Robinson-Patman Act was specifically enacted to have greater scope; it uses express language that applies to unilateral conduct by firms lacking any prospect of single-firm monopoly. The court rested its narrowing application of the Act on its own "theoretical suspicions" that an oligopolist acting unilaterally would never price below cost to discipline a rival because it could never be "assured" of a payoff in supracompetitive prices. Pet. App. 12a, 14a. The court's speculations were faulty economics and bad law. It is widely recognized that oligopolists can reap and reasonably expect to maintain monopoly-level prices and profits without any express conspiracy. Moreover, the court misread *Matsushita Electric Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), as permitting it to substitute its own "economic logic" for the jury finding of anticompetitive conduct by an actual oligopolist. That finding was supported by proof meeting the strictest test of the statutory language and is fully consistent with antitrust policy.

The Fourth Circuit's immunization of unilateral conduct by an oligopolist -- no matter how anticompetitive -- cannot be defended as a statutorily authorized "bright line" needed to forestall a flood of challenges to procompetitive pricing. No such flood could pass through all the filters that, in cases like this one, allay any genuine concern that procompetitive pricing may be mistaken for disciplinary predation. Substantial, unjustified and discriminatory prices below average variable cost with a reasonable prospect of

recoupment suffice to show the reasonable possibility of injuring competition that violates the Robinson-Patman Act.

Second, as erroneous support for its first conclusion or possibly as an alternative to it, the court below insisted that any otherwise unlawful predatory plan had been unsuccessful. In an error of law, the court deemed the predatory plan unsuccessful simply because the generic market segment had expanded, ignoring the increase in all cigarette prices as the gap between regular brands and generics narrowed. Higher prices, which were acknowledged, suffice in and of themselves to establish injury to competition. In any event, improper price discrimination undertaken with a reasonable potential for injuring competition violates the Robinson-Patman Act even if not ultimately successful.

ARGUMENT

I. THE FOURTH CIRCUIT ERRONEOUSLY RESTRICTED THE SCOPE OF THE ROBINSON-PATMAN ACT -- CONTRARY TO ITS LANGUAGE AND PURPOSE, TO PRECEDENT, TO SOUND ECONOMICS, AND TO THE WELL-SUPPORTED JURY VERDICT.

A. The Robinson-Patman Act is Not Limited To Single-Firm Monopoly or Conspiracy Already Covered by the Sherman Act.

The effect of the Fourth Circuit ruling was to limit the Robinson-Patman Act proscription of predatory and disciplinary pricing to monopolies and conspiracies, classes of conduct already forbidden by Sherman Act §§1-2. By thus granting *per se* immunity for disciplinary price discrimination in the absence of actual or prospective monopoly or express cartelization, the court disregarded the language and purpose of the Robinson-Patman Act. By its own terms, the statute applies to a single firm's price discrimination the effect of which "may be substantially to lessen competition or tend to create a monopoly . . . or to injure . . . competition with [the discriminating seller]. . . ." Pet. App. 54a. The Act's

reference to single-firm conduct is inconsistent with any conspiracy requirement, and the disjunctive language obviates any monopoly requirement. Indeed, it was Congress' intent that this statute reach conduct "not covered by the [Sherman Act]."²⁵

To be sure, the Robinson-Patman Act and Sherman Act §2 share a common goal of protecting consumers who may ultimately be injured by predatory pricing.²⁶ Cases under both Acts employ a common test for distinguishing proper from improper prices²⁷ and recognize that consumers are directly injured by the creation or perpetuation of

²⁵ S. Rep. No. 698, 63d Cong. 2d Sess. 2 (1914). Sixty years later, a special House subcommittee recommended against limiting the Robinson-Patman Act's primary-line scope to that of the Sherman Act, for "no one has articulated a sound basis for radically limiting the Act's primary-line competition reach." Ad Hoc Subcommittee on Antitrust, The Robinson-Patman Act and Related Matters, Recent Efforts to Amend or Repeal the Robinson-Patman Act, H.R. Rep. No. 1738, 94th Cong. 2d Sess. 76 (1976).

²⁶ See *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 688 F.2d 1014, 1042 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982) ("In primary-line Robinson-Patman Act cases . . . the distinction between vigorous, but honest, price competition and predatory assaults on the competitive process is just as important as it is to Sherman Act cases brought under its section 2."); *O. Hommel Co.*, 659 F.2d at 348-50 ("A focus on detrimental effects on competition rather than a concern with individual competitors is fundamental to a reconciliation of the Robinson-Patman Act with overall antitrust policies.").

²⁷ *International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d 714, 720 n.10 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976); *Henry*, 809 F.2d at 1345; *Pacific Engineering & Prod. Co.*, 551 F.2d at 798; *Janich Bros. v. American Distilling Co.*, 570 F.2d 848, 855 (9th Cir. 1977), *cert. denied*, 439 U.S. 829 (1978); *D.E. Rogers Assoc.*, 718 F.2d at 1439; *O. Hommel Co.*, 659 F.2d at 348-50; *William Inglis & Sons Baking Co.*, 668 F.2d at 1042; *McGahee v. Northern Propane Gas Co.*, 858 F.2d 1487, 1493 n.9 (11th Cir. 1988), *cert. denied*, 490 U.S. 1084 (1989).

supracompetitive prices through which the investment in a predatorily low price is recouped. Thus, the prospect of recoupment indicates that competition is genuinely threatened and reassures the tribunal that an unjustified below-cost price is truly predatory.

Notwithstanding these shared goals and techniques, the statutes are not coterminous.²⁸ By its own terms, the Sherman Act requires conspiracy or actual or prospective monopoly, while the Robinson-Patman Act reaches price discrimination where the effect "may be to substantially lessen competition," whether or not accompanied by monopoly or conspiracy. Congress used the very same "effect" language in Clayton Act §7, which recognizes that mergers without any prospect of single-firm monopoly or conspiracy with others can illegally bring about or reinforce supracompetitive oligopoly prices. As elaborated in Section B *infra*, an oligopoly's supracompetitive prices can provide the payoff for below-cost pricing designed to ruin or discipline a disruptive rival.

Given that risk, Congress's concern in the Robinson-Patman Act with primary-line price discrimination threatening competition -- even absent single firm monopoly or an illegal cartel -- was not misplaced. Price discrimination allows a predator to target its price cuts, thereby lowering its investment in below-cost pricing and making recoupment more likely. In B&W's words, a predatory oligopolist can "[p]ut the money where the volume is." J.A. 402. B&W targeted its largest discounts to Liggett's largest 14 customers, thereby inflicting maximum disciplinary pressure upon Liggett at least cost to itself. *See supra* pp. 12-13.

This straightforward way in which price discrimination can threaten competition is sometimes misunderstood. For example, the District Court suggested that the higher of the discriminatory prices ("high price") must subsidize the lower

²⁸ *See, e.g., William Inglis & Sons Baking Co.*, 668 F.2d at 1042 ("[w]e do not hold that there exists a complete substantive synchronization of the Sherman and Robinson-Patman Acts.").

of the discriminatory prices ("low price") before discrimination can "cause" injury to competition. Pet. App. 38a-42a. In a standard illustration, a normal above-cost (or even monopolistic) price in one geographic market accompanies a predatory below-cost price in a different geographic market to which the victim is confined. However, that high price does not make the low price profitable, currently or ever: If the lower price is predatorily below cost, it can benefit the predator only by destroying or disciplining a rival and thereby helping achieve or maintain supracompetitive prices in the victim's region. True, the normal price in one region can provide the cash that the predator invests in the predatorily low price, but "it does not ordinarily matter whether the money to pay for the resulting temporary loss comes from a bank account, a legacy, a lottery prize, or the proceeds of a price fixing conspiracy in respect to another product."²⁹ True also, the victim of predatory price discrimination might outlast the attack if it also sells to the high-price customers -- as when it operates in both regions or when the discrimination is non-geographic -- but not when, as in the present case, the high price is itself below average variable cost and the predator expressly and accurately predicts that the losses it inflicts upon the target will be insufferable.

In sum, price discrimination can endanger competition by facilitating predatory pricing. Thus, there is no reason to resist the express language of the Robinson-Patman Act in its coverage of all improper discrimination (whether or not geographic) and all improper discriminators (whether or not monopolists or conspirators). This accords with the statute's express language and with the purpose declared in its legislative history to reach conduct beyond that reached by the Sherman Act.

²⁹ *Clamp-All Corp. v. Cast Iron Soil Pipe Institute*, 851 F.2d 478, 485-86 (1st Cir. 1988), *cert. denied*, 488 U.S. 1007 (1989) (Breyer, J.; Sherman Act).

B. Economic Theory Does Not Require Conspiracy or Single-Firm Monopoly as a Predicate for Predatory Pricing.

It is widely recognized that oligopolists can reap monopoly-level prices and profits without any express conspiracy. By "oligopolistic interdependence" . . . in contrast to the explicit collusion of the formal cartel or its underground counterpart," sellers might "coordinate their pricing without conspiring in the usual sense of the term."³⁰ Though it may be "profoundly anticompetitive"³¹ and able to "reap supracompetitive prices" merely as a result of rivals observing and following each other,³² the non-conspiratorial oligopoly is not itself illegal. Nevertheless, maintaining supracompetitive profits can provide the recoupment rewarding a predatory oligopolist.

To be sure, destroying all one's rivals eliminates all present competition while rivals remain after an oligopolist disciplines a maverick. This difference between monopolistic and oligopolistic predation has two implications. *First*, if predation is successful, the monopolist alone reaps its fruits, while an oligopolist must share the fruits with surviving oligopolists, and the smaller oligopolist may benefit less from reinforced supracompetitive prices than the larger ones. In this case, B&W believed that the larger firms feared antitrust liability and that therefore they would not discipline Liggett. J.A. 76, 93. B&W wrote that if it "put the lid on L&M," no one else would have to. J.A. 61. Although doing so would benefit fellow oligopolists too, B&W calculated that it alone would benefit enough -- up to \$350 million by 1988 -- to

³⁰ R. Posner, *Antitrust Law* 40 (1976). See also 6 P. Areeda, *Antitrust Law* ¶ 1410b at 66 (1986). B&W's economic expert also acknowledged that consumers faced with a tightly-knit oligopoly are likely to pay elevated prices. J.A. 741-42.

³¹ *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 367 n.43 (1963).

³² *Eastman Kodak Co. v. Image Technical Serv. Inc.*, ___ U.S. ___, 112 S. Ct. 2072, 2086 n.21 (1992).

make its investment in disciplining Liggett pay off handsomely. J.A. 83. When the gains to be achieved are large enough relative to the costs of disciplining a maverick,³³ predation becomes an entirely rational strategy for an oligopolist. Indeed, this Court has recognized that predation is plausible when an investment in below-cost sales can be more than paid back either by obtaining "future monopoly profits" (where rivals are to be eliminated) or by protecting "future undisturbed profits" (where rivals are to be disciplined) -- defining "monopoly profits" as "enough market power to set higher than competitive prices." *Matsushita Electric Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589-90 (1986).

A *second* difference between predatory monopoly and oligopoly is that a predator anticipating entry-resistant monopoly hopes that it alone will set the post-predation price, while an oligopolist such as B&W knows that future prices depend upon the choices of fellow oligopolists. Because fellow oligopolists and a would-be predator could not be "certain" and "assured" of each other's motives and reactions, the Fourth Circuit ruled oligopolistic predation irrational. Pet. App. 11a, 14a.

That court's demand for certainty requires the impossible -- whether a predator is an aspiring monopolist, a cartel, or an oligopolist. A would-be monopolist cannot be certain that it will actually obtain a monopoly or that the monopoly price will be high enough and last long enough without new entry to recoup the predatory investment. Certainty is similarly impossible in an express cartel, whose members may "cheat."³⁴ If certainty were a prerequisite to threatened impairments of competition, antitrust law would have no occasion to fear the mergers that create oligopoly or

³³ From the predator's viewpoint, relatively speedy discipline requires a smaller investment in below-cost pricing than slower destruction.

³⁴ See F. Scherer and D. Ross, *Industrial Market Structure and Economic Performance* 238 (3d ed. 1990).

the practices that facilitate its supracompetitive pricing. Yet, antitrust law does prohibit mergers that create or reinforce oligopoly³⁵ as well as practices that facilitate oligopoly pricing.³⁶ Competition can be harmed not because oligopolists are certain of their rivals' reactions, but because each can calculate the gains to be achieved if rivals react in a specified way and then estimate the probabilities that rivals will so behave.

Not only were the Fourth Circuit's "theoretical suspicions" unwarranted for the generality of cases, they were singularly misplaced in the present case. In the cigarette industry, there was little risk (1) that oligopoly pricing would break down or (2) that the oligopolists would misperceive disciplinary price-cutting as promotional and respond with aggressive price cuts of their own, thereby frustrating the maintenance of supracompetitive prices. As to the first, the court failed to mention the record evidence that this industry has long been the textbook example of long-maintained supracompetitive prices and profits.³⁷ See *supra* pp. 5-7. The likelihood that the cigarette market would continue to behave as the classic oligopoly it has been for decades was far greater than the prospect that, for example,

³⁵ U.S. Department of Justice and Federal Trade Commission Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104 (1992) at 20,571, are founded on the recognition that "in some circumstances, where only a few firms account for most of the sales of a product, those firms can exercise market power, perhaps even approximating the performance of a monopolist by either explicitly or implicitly coordinating their actions."

³⁶ See, e.g., *United States v. Container Corp.*, 393 U.S. 333 (1969).

³⁷ See F. Scherer and D. Ross, *Industrial Market Structure and Economic Performance* 250-51 (3d ed. 1990) (describing successful price disciplining in the 1930s and the 1980s' experience when despite "the reappearance of low price brands, and falling consumption, the leading U.S. cigarette manufacturers raised prices sufficiently to increase their profits from \$3.80 to \$11.55 per thousand cigarettes sold between 1980 and 1988.") (read into record at J.A. 748).

members of the express OPEC cartel would refrain from cheating or that a would-be monopolist would gain and keep a monopoly.

As to the potential reactions of the other oligopolists, the Fourth Circuit acknowledged, "Oligopolists might indeed all share an interest in letting one among them discipline another for breaking step and might all be aware that all share this interest." Pet. App. 11a. However, in the court's view,

The oligopolist on the sidelines would need to be certain at least that it could trust the discipliner not to expand the low-price segment itself during the fight or after its success. Of course, all the oligopolists on the sidelines would need to be certain that the others were also confident on this point. Such confidence must be rare, indeed, when the form that the discipline takes is a price-war, which must strike fear in the heart of any oligopolist hoping to protect market share and high prices. More likely, when members of an oligopoly are faced with a competitor's decision to break step, drop prices, and expand market share, they would react competitively. Pet. App. at 11a-12a.

In fact, B&W did not believe the other oligopolists would "react competitively," and it was right. B&W examined each rival in turn and analyzed how each would react to Liggett's conduct and to B&W's projected plan to discipline Liggett. J.A. 83-87. Directly contrary to the Fourth Circuit's "theoretical suspicions," B&W memoranda explained that it would "signal [its] intent to competition" that its entry and rebates would "not expand [the] segment." J.A. 61. Discriminatory rebates -- as distinct from list-price reductions reaching consumers -- have that effect. B&W concluded (correctly) that its rivals most likely would "enter the new segment" but would be eager "to manage prices and profitability upward" to the detriment of the consumer. J.A. 131-32.

Furthermore, B&W's "war" was limited to black-and-whites, hurting Liggett rather than the other oligopolists, who (unlike Liggett) did not rely on black-and-whites for either volume or profits. The "war" did not extend to list-price reductions that would draw additional consumers away from the regular brands of fellow oligopolists. Indeed, no other manufacturer was drawn into the "price war." For example, Reynolds did not change its small Doral rebate during the 1984 war of escalating black-and-white rebates. Tr. 105: 64-65. In sum, the Fourth Circuit's "theoretical suspicions" were logically flawed and so, unsurprisingly, were belied by the facts.

C. Using Economic Theory To Immunize Actual Predatory Conduct As Found By The Jury Contradicts Precedent and Good Sense.

Beyond misunderstanding economics and failing to consider the language and purpose of the statute, the court below erred fundamentally in its methodology. Notwithstanding a fully developed record and jury verdict, the court held that its abstract speculations about the profit-maximizing choices of a hypothetical oligopolist made it unnecessary to consider the conduct and market analyses of the actual and highly sophisticated defendant before it. To be sure, economic theory, at least when well-founded, can indicate what evidence would be helpful and can illuminate both evidentiary ambiguities and legal standards. However, once conduct has been proven to occur, it is illogical and legally improper to immunize it on the ground that "theoretical suspicions" suggest that such conduct is unlikely to occur.³⁸

³⁸ The Fourth Circuit did not deny that a reasonable jury could find that B&W's prices were unjustified, were below average variable cost, were designed to and did in fact discipline Liggett, and that consumer prices rose as a result of B&W's conduct. If the Fourth Circuit rested on the belief that B&W's anticompetitive conduct did not succeed in injuring competition, it made two errors of law. See *infra* Section II p. 43.

The Fourth Circuit defended its approach with a patent misreading of *Matsushita Electric Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). *Matsushita* held that the existence of a conspiracy to engage in predatory pricing could not be inferred from circumstantial evidence when there would have been no economically plausible means for the alleged conspirators to recoup any losses from conspiratorial low prices. However, *Matsushita* recognized that judicial doubts about the chances of success must be set aside once there is evidence that the defendants have actually engaged in the alleged conduct. *Id.* at 597. Moreover, *Matsushita* declared that "direct evidence of below-cost pricing is sufficient to overcome the strong inference that rational businesses would not enter into conspiracies such as this one." *Id.* at 585 n.9. Contrast the Fourth Circuit's erroneous statement that

the Court in *Matsushita* held that a conspiracy, which could not hope to recoup its expenses incurred from alleged below-cost pricing and was therefore economically senseless, did not violate the antitrust laws. Pet. App. 9a.

The Fourth Circuit thus declared that *actual* below-cost pricing by a sophisticated actor reasonably intending to discipline a rival, to injure consumers, and to obtain recoupment from the industry's persistent supracompetitive profits -- key factors under the Robinson-Patman Act and analogous to the Sherman Act conspiracy factor in *Matsushita* -- is not unlawful because the court deemed success unlikely and therefore concluded that B&W would have been irrational to do what it was proven to have done.

The Fourth Circuit's error is demonstrated *a fortiori* by *Eastman Kodak Co. v. Image Technical Serv., Inc.*, ___ U.S. ___, 112 S.Ct. 2072, 2082 (1992), which "focus[ed] on the 'particular facts disclosed by the record'" to illuminate "market realities." Disapproving summary judgment for defendant in that case, this Court relied on limited evidence of liability that tended to contradict a compelling chain of

economic reasoning supporting the defendant.³⁹ In stark contrast, the Fourth Circuit rejected a well-supported finding of liability that was *consistent with* a compelling and well-accepted concern with supracompetitive oligopolistic pricing. That jury finding accords with an economic proposition pervading antitrust law -- that supracompetitive pricing can occur without illegal conspiracy in highly concentrated markets. *See supra* p. 28. The jury was surely entitled to believe that cigarettes constituted such a market. *See supra* pp. 5-7.

The Fourth Circuit also ignored this Court's instruction in *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918) (Brandeis, J.), that "knowledge of intent may help the court to interpret facts and to predict consequences." The court below ruled in effect that its speculations about the workings of the cigarette market were so far superior to the sophisticated defendant's own judgments about that market that B&W's market analyses and predictions could be disregarded. Although one might disregard the fantasy of an irrational or uninformed person, B&W is neither. A reasonable tribunal must surely weigh heavily B&W's own high-level documents explaining the way this market works, the nature and function of B&W's pricing, and its predictions that Liggett would be forced to raise prices and that fellow oligopolists would not interfere.⁴⁰ The speculation of

³⁹ In that tying case, liability depended on proof of Kodak's power over a tying product of distinctive repair parts for its machines. Because Kodak lacked power in the machine market and because sophisticated buyers would take account of repair prices when buying machines, Kodak argued that its power over repair parts could never exceed its non-existent power over machines. Acknowledging that Kodak might be able to offer facts supporting its reasoning, the Court pointed to evidence suggesting that some buyers were unsophisticated and therefore required further exploration before approving summary judgment that had terminated the case after only truncated discovery.

⁴⁰ *See Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 372 (1933); L. Sullivan, *Handbook of the Law of Antitrust* 195 (1977) ("The actors in the marketplace will often be themselves the best

lawyers and judges about the workings of a particular market is no substitute for a sophisticated defendant's own carefully designed market analysis and unambiguous plan. "Wisdom lags far behind the market [L]awyers know less about the business than the people they represent. . . . The Judge knows even less about the business than the lawyers." Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 5 (1984).

D. The Most Demanding Standard for Robinson-Patman Act Liability Was Met.

This Court last addressed primary-line injury to competition in *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967), which approved a jury verdict condemning both geographic and nongeographic price discrimination.⁴¹ There was no element of monopoly or conspiracy. The defendants in *Utah Pie* were three national firms that sold frozen pies in Utah at prices below cost and below their prices in other markets. One defendant had identified plaintiff as an "unfavorable factor," sent an industrial spy into Utah Pie's plant, and accepted "substantial losses" in Utah that a jury might rationally attribute to its low prices there. *Id.* at 697. Another defendant's Utah prices were "less than its direct cost plus an allocation for overhead" during several two-week periods. *Id.* at 698. And the third

judges of what they are capable of achieving, and if they are aimed at wrongful acts we may logically treat their purposes as a guide to what they will accomplish."); 7 P. Areeda, *Antitrust Law* ¶ 1506 at 393-94 (1986).

⁴¹ Earlier primary-line cases addressed other issues -- defining price discrimination in *FTC v. Anheuser-Busch, Inc.*, 363 U.S. 536 (1960), and interstate commerce in *Moore v. Mead's Fine Bread Co.*, 348 U.S. 115 (1954). But *Anheuser-Busch* did note that "it might be argued that the existence of predatory intent bears upon the likelihood of injury to competition, and that a price reduction below cost tends to establish such an intent," *Anheuser-Busch*, 363 U.S. at 552 (footnote omitted), while *Moore* suggested that elimination of a rival satisfies the Act's effects clause, *Moore*, 348 U.S. at 118.

defendant's price was for a time "admittedly well below its costs, and well below the other prices prevailing in the market." *Id.* at 701. In sum, "with respect to each" defendant, "there was some evidence of predatory intent," which supported an inference of injury to competition when supplemented by evidence of defendants' downward pressure on prices in a "highly competitive market" and the resultant "drastically declining price structure." *Id.* at 702-03. The Court held such evidence sufficient to support a finding of injury to competition as to each of the defendants, because "the Act reaches price discrimination that erodes competition as much as it reaches price discrimination that is intended to have immediate destructive impact." *Ibid.*

Lower courts have read *Utah Pie* to allow juries to infer injury to competition from a "drastic[]" market impact and/or "predatory intent" and to infer the latter either from direct evidence of the defendant's purpose or from below-cost pricing.⁴² At the same time, the lower courts have refined the *Utah Pie* standard to accommodate subsequent decades of antitrust development. They clarified the relevant intent, analyzed price-cost relationships, and recognized that the prospect of recoupment -- connecting present below-cost prices injuring rivals with the achievement or maintenance of high prices injuring consumers -- helps distinguish predatory from competitive pricing. B&W's pricing in this case is unlawful by any and all of these tests.⁴³

Intention. An extreme reading of *Utah Pie* and of some earlier lower court precedent allows a jury to view aggressive conduct toward a smaller rival as threatening to

⁴² This reading produced the now-conventional "double inference" instruction given (and supplemented) in this case. See *supra* p. 19.

⁴³ Entirely misleading, therefore, is the Fourth Circuit's suggestion that Liggett defends the verdict on the ground that B&W's realized intent to injure Liggett itself suffices for illegality under *Utah Pie*. Pet. App. 7a-8a.

competition.⁴⁴ By that standard, of course, B&W's liability is demonstrated *a fortiori*.

More recent cases have wisely sought to link "predatory intent" with an improper attack on the marketplace and have defined it as the intent to "sacrific[e] present revenues with the purpose of achieving monopoly profits in the future," *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340, 348, *cert. denied*, 455 U.S. 1017 (1982), not simply the desire to injure competitors. *Accord International Air Indus., Inc. v. American Excelsior Co.* 517 F.2d 714, 723 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976) ("By 'predatory' we mean that [defendant] must have at least sacrificed present revenues for the purposes of driving [plaintiff] out of the market with the hope of recouping the losses through subsequent higher prices."); *Lomar Wholesale Grocery, Inc. v. Dieter's Gourmet Foods, Inc.*, 824 F.2d 582, 596 (8th Cir. 1987), *cert. denied*, 484 U.S. 1010 (1988) ("the predatory intent . . . must relate to the market as a whole.").

In the present case, the evidence disclosed B&W's anti-consumer, as well as its anti-Liggett, state of mind. It expressed an unambiguous, sophisticated analysis of the market, calculating precisely how it could force Liggett to raise its black-and-white prices. It also analyzed how it could profit from disciplining Liggett, even though fellow oligopolists were significant in the cigarette market. This is the kind of evidence that best illustrates how "knowledge of intent may help the court to interpret facts and to predict consequences." *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918). In no other reported decision is a predatory plan so clearly set forth in the defendant's own memoranda -- a fact acknowledged by the District Court itself. Pet. App. 31a.

⁴⁴ See, e.g., *National Dairy Prods. Corp. v. FTC*, 412 F.2d 605, 618-20 (7th Cir. 1969). To avoid such extreme readings, many lower courts largely ignore *Utah Pie*, as the Fourth Circuit did here, or arbitrarily confine it to geographic discrimination, as in *O. Hommel and Barr Labs., Inc. v. Abbott Labs.*, 978 F.2d 89 (3d Cir. 1992).

Below-Cost Pricing. Although many lower courts use the rubric of predatory intent, they infer that intent from below-cost pricing. See *supra* p. 19. *Utah Pie* itself saw the significance of price-cost relationships long before later authorities elucidated which cost measures were most relevant -- a task that *Utah Pie* had not attempted.⁴⁵ In that case, the Court spoke only of prices below average total cost. By that standard, B&W's liability is again established *a fortiori*.

Today, some courts admit the possibility of predation even when prices exceed average variable cost⁴⁶ or average total cost.⁴⁷ In any event, all the lower courts would find at least presumptive impropriety when prices persistently fail to cover average variable costs.⁴⁸ That presumption is well

⁴⁵ See *William Inglis & Sons Baking Co.*, 668 F.2d at 1041 n.48 ("there is no indication that the [*Utah Pie*] Court meant to establish average total cost as the immutable dividing line in all Robinson-Patman Act cases."); *Ashkenazy v. I. Rokeach & Sons, Inc.*, 757 F. Supp. 1527, 1550 (N.D. Ill. 1991) (*Utah Pie*'s concern was "to root out predatory pricing, and therefore more reliable measures of cost developed subsequently can (and should) be substituted without upsetting the holding or reasoning of *Utah Pie*.").

⁴⁶ *Henry*, 809 F.2d at 1346; *McGahee*, 858 F.2d at 1503-04; *William Inglis & Sons Baking Co.*, 668 F.2d at 1041; *Instructional Systems Development Corp. v. Aetna Casualty & Surety Co.*, 817 F.2d 639, 648 (10th Cir. 1987) (Sherman Act); *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*, 615 F.2d 427, 432 (7th Cir. 1980) (same).

⁴⁷ *Transamerica Computer Co. v. International Business Machines*, 698 F.2d 1377, 1388 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983) (Sherman Act); *International Air Industries, Inc.*, 517 F.2d at 724. *Contra Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227 (1st Cir. 1983) (Sherman Act); *McGahee*, 858 F.2d at 1503; *Arthur S. Langenderfer, Inc. v. S.E. Johnson Co.*, 729 F.2d 1050, 1056 (6th Cir.), *cert. denied*, 469 U.S. 1036 (1984) (Sherman Act).

⁴⁸ *Henry*, 809 F.2d at 1346; *McGahee*, 858 F.2d at 1504; *William Inglis & Sons Baking Co.*, 668 F.2d at 1041; *Janich Bros.*, 570 F.2d at 858; *Pacific Engineering & Prod. Co.*, 551 F.2d at 797; *D.E. Rogers*,

founded, for every such sale *increases* the seller's losses. Such a price is so low that "one would know that the firm cannot rationally plan to maintain this low price . . . [I]t would do better to discontinue production." *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 232 (1st Cir. 1983) (Sherman Act). "There is no reason consistent with an interest in efficiency for selling a unit at a price lower than the cost that the seller incurs by the sale." Posner, *Exclusionary Practices and the Antitrust Laws*, 41 U. Chi. L. Rev. 506, 519 (1974).

In the present case, B&W sold black-and-whites well below their average variable cost for 18 months. J.A. 338-39. To infer predatory intent from below-cost pricing, the jury was instructed that it had to find that B&W priced below its average variable costs.⁴⁹ Instr. No. 18, J.A. 834. The jury was also specifically instructed to absolve B&W if its prices were introductory, promotional, or adopted in good faith to meet competition. Instr. Nos. 26, 27, and 33, J.A. 841, 846.

True, B&W continued to earn supracompetitive profits on regular brands such that its revenues exceeded its costs for cigarettes as a whole. However, branded profits do not make loss-creating prices on black-and-whites promotional or

718 F.2d at 1436-37; *In the matter of International Telephone & Telegraph Corporation*, 104 F.T.C. 280, 403-04 (1984); *Northeastern Tel. Co. v. American Tel. & Tel. Co.*, 651 F.2d 76, 88 (2d Cir. 1981), *cert. denied*, 455 U.S. 943 (1982) (Sherman Act); *Kelco Disposal, Inc. v. Browning-Ferris Industries*, 845 F.2d 404, 407 (2d Cir. 1988), *aff'd on other grounds*, 492 U.S. 257 (1989) (Sherman Act); *Chillicothe Sand & Gravel Co.*, 615 F.2d at 432 (Sherman Act). See also *Barry Wright Corp.*, 724 F.2d at 242 (1st Cir. 1983).

⁴⁹ Accordingly, this Court can repeat here what it said twice before: "[I]n this case . . . we find it unnecessary to 'consider whether recovery should ever be available . . . when the pricing in question is above some measure of incremental cost.'" *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 117 n.12 (1986), quoting *Matshushita*, 475 U.S. at 585 n.9.

otherwise legitimate.⁵⁰ The danger posed to competition in the cigarette market was that supracompetitive profits on regular-brand cigarette sales would be preserved by weakening or eliminating the deep-discounted, black-and-white generic cigarettes promoted by Liggett. That threat to competition was hardly offset by the existence of the very supracompetitive profits on regular-brand cigarettes that B&W's conduct had the purpose and effect of protecting.

While profits on regular-brand cigarettes may bear on how long B&W and Liggett would tolerate losses on black-and-whites, Liggett's regular-brand sales were a much smaller share of its total sales. In any event, B&W itself accurately predicted that the losses it inflicted on Liggett would force Liggett to raise list prices on black-and-whites. Thus, B&W's below-average-variable-cost prices on black-and-whites had the requisite potential to injure competition.⁵¹

Recoupment. *Utah Pie* did not ask whether the challenged low price presaged the achievement or maintenance of higher prices -- a question that came to be expressed a decade or more afterward as the prospect of recoupment. Today, some courts include a prospect of recoupment within the definition of predatory intent,⁵² as in

⁵⁰ Contrast a grocery store's "loss-leader" below-cost milk price. It brings into the store additional customers who will buy something else while there. It thus increases overall sales and *short-run* profits -- an *immediate* profit-increasing strategy that rivals can match with milk or something else. B&W made no claim that its losses on generics promoted the sale of any other product and their opposite effect on sales of regular brands is conceded. Moreover, the jury necessarily found that B&W's pricing was not introductory or otherwise legitimate. Instr. Nos. 27, 28 and 33, J.A. 841, 842, 846.

⁵¹ The identical point can be expressed this way: In the circumstances of this case, black-and-whites are the relevant universe in which to compare prices and costs in order to apply the average-variable-cost-test.

⁵² See *Henry*, 809 F.2d at 1344, 1347.

the present case, or make proof of plausible recoupment a predicate for undertaking price-cost comparisons.⁵³ Requiring a recoupment potential serves, as in *Matsushita*, to eliminate implausible inferences drawn from ambiguous circumstantial evidence: When recoupment is patently impossible, predation is irrational, and the defendant is either acting on fantasy or pricing properly.

As discussed above, however, recoupment is entirely plausible in oligopolies such as the highly concentrated cigarette industry, and surely the jury was reasonable in finding it a genuine prospect here, given persistent supracompetitive prices and high entry barriers, \$350 million of threatened regular-brand revenue which provided a source of recoupment, and careful, explicit, and unambiguous market analysis in B&W's sophisticated, high-level documents.

E. Liability Here Would Not Impair Legitimate Price Competition.

Antitrust law must, of course, be sensitive to the danger of mischaracterizing competition as predation and thereby chilling price competition, especially in those oligopolies where price competition is already fragile. Competitors might too often respond to procompetitive price reductions with a lawsuit. Perhaps an unstated concern about such potentially unjustified claims moved the Fourth Circuit to draw its bright line excluding all cases of predation outside of monopoly or cartel settings, though such an exclusion is

⁵³ See *Ashkenazy*, 757 F. Supp. at 1549 (in light of *Matsushita* and *Cargill*, "the threshold determination of the economic plausibility of a predatory pricing scheme should be included in predatory pricing analysis under *Utah Pie* and should end the inquiry if market conditions are not found to support the economic rationality of predatory behavior."). But see *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396, 1403-06 (7th Cir. 1989), *cert. denied*, 494 U.S. 1019 (1990) (plausible recoupment required to show predation under Sherman Act but not to show threat to competition under *Utah Pie* and the Robinson-Patman Act).

contrary to the statute's own language. But any such concern would be misplaced, for it wrongly assumes that the courts must choose one of two extreme rules: allow a primary-line Robinson-Patman Act suit only when a monopoly or cartel is involved or allow juries to find liability on baseless claims of disciplinary pricing. Either of these choices will harm consumers. Immunizing all predatory or disciplinary price discrimination in every oligopolistic market invites disciplinary conduct bringing about higher prices, just as undue hospitality to predation suits discourages lower prices.

There is no danger that imposing liability in the present case would bring a flood of baseless verdicts. No baseless claim could successfully pass all the filters through which this case has passed:

1. Price-discrimination that neither is cost-justified nor meets competition in good faith.
2. Sustained prices that are below average variable cost and that are not introductory, promotional, or otherwise legitimate.
3. Express and unambiguous proof of a motive to force a rival to raise prices -- that is, to injure consumers.
4. Express, unambiguous, and accurate market analysis by the alleged predator of how it can discipline the rival.
5. Express, unambiguous, and accurate market analysis by the alleged predator of how fellow oligopolists will behave so as to bring about higher market prices.
6. Express calculation by it of the amount and source of recoupment in a highly concentrated market with a history of supracompetitive prices and entry barriers.

No plausible construction of the Robinson-Patman Act could require more.⁵⁴ Indeed, the conventional instruction given the jury in many circuits was supplemented in this case by language expressly conditioning liability on B&W's pricing below cost with a reasonable prospect of recoupment through supracompetitive prices.⁵⁵ Instr. No. 12, J.A. 829.

This Court should rule that substantial, unjustified, and discriminatory pricing below average variable cost with a reasonable prospect of recoupment suffices to show the reasonable possibility of injuring competition that violates Robinson Patman Act §2(a).⁵⁶

⁵⁴ Although actual detrimental effects are not required, higher consumer prices resulted. See Part II of this brief.

⁵⁵ The conventional instruction allows the requisite injury to competition to be inferred from either (1) actual diminished competition in the market place or (2) "predatory intent" which in turn may be inferred from (a) direct evidence of intent or (b) pricing below average variable cost. The first prong might seem to be triggered by, say, increased concentration even though discriminatory prices greatly exceeded costs; the second prong may direct undue attention to state of mind. In actual application, however, courts often emphasize pricing below average variable cost with a reasonable prospect of recoupment. See, e.g., *Lomar Wholesale Grocery, Inc.*, 824 F.2d at 597-99.

A simpler and clearer instruction would state which of the six factors listed in the text need to be found. However, the instruction given in the present case was satisfactory because the conventional terms were supplemented as just stated in the text.

⁵⁶ A reasonable prospect of recoupment can be inferred from the likelihood of effective oligopolistic pricing at supracompetitive levels, from a history of such pricing, or from the clear market analysis of a sophisticated and informed defendant.

II. THE FOURTH CIRCUIT ERRED, AS A MATTER OF LAW, IN DEFINING ANTICOMPETITIVE EFFECTS AND/OR IN REQUIRING THEM.

The Fourth Circuit believed its "theoretical suspicions" were "confirmed" by the "perfect vision of hindsight," which saw a larger market share for discounted cigarettes notwithstanding a shrunken discount and higher prices for both generic and regular-brand cigarettes. The court may have meant merely that its theory of impossible oligopolistic predation was borne out by events. Or it may have intended an alternative holding that the absence of consummated injury to consumers absolves otherwise predatory conduct. In either event, it erred as a matter of law. The price rise that actually occurred constituted injury to consumers. Moreover, substantial, unjustified, and discriminatory pricing below average variable cost with a reasonable prospect of recoupment violates the statute whether or not prices rise.

The court below led itself astray by misdefining B&W's objective as stopping the growth of the generic sector, rather than merely slowing that growth by managing prices upward -- that is, by stabilizing and then shrinking the gap and thus weakening the generic brake on rising cigarette prices generally. It is clear that higher prices themselves count as an actual injury to competition and consumers. *E.g.*, *NCAA v. Board of Regents of University of Oklahoma*, 468 U.S. 85, 106-07 (1984). Moreover, a reasonable jury could conclude that the generic segment would have been even larger in the absence of B&W's predatory conduct.⁵⁷

⁵⁷ B&W's own economic expert acknowledged that competition is injured by inducing a rival to reduce its competitive efforts (J.A. 650), and the District Judge said in denying B&W's request for a directed verdict:

A year after Brown & Williamson's entry, they recognize - and their executives recognize - that plaintiff's consumer advertising had been reduced, and the growth of the category appeared to have slowed. The slowing of the growth of the

Compounding its misconception of what constitutes an anticompetitive effect, the Fourth Circuit also erred if it intended to hold that actual injury to consumers is a prerequisite to the violation. Imposing such a prerequisite is contrary to the statute, which condemns discriminatory pricing where the effect "*may be* substantially to lessen competition . . ." (emphasis added). It is also wrong in principle, because conduct should be judged as of the time it occurs. Doing so educates would-be predators as to their duties under the statute and thus protects the market from unjustified conduct posing a genuine threat to competition. Genuinely dangerous conduct should be prohibited notwithstanding its abandonment after a legal challenge or lack of success. Substantial, unjustified, and discriminatory pricing below average variable cost with a reasonable prospect of recoupment creates the reasonable possibility of injuring competition, as forbidden by the statute and found by the jury in this case.

The lower courts generally understand the point. For example, the Eighth Circuit requires "some reasonable expectation on the part of the alleged predator that it will succeed" while recognizing that "predatory intentions need not be accomplished." *Henry v. Chloride, Inc.*, 809 F.2d 1334, 1345 n.9 (8th Cir. 1987). See also *International Air Indus. Inc. v. American Excelsior Co.*, 517 F.2d 714, 720 n.10 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976) ("Under the Robinson-Patman Act, of course, it is not necessary to show actual damage to competition, it is only necessary to show that there is a reasonable possibility that

category gives recoupment in the branded sales retained, and a slowing of the growth of the segment can lessen the downward pull on the branded prices. And, in fact, the gap did narrow between branded and generic [prices] according to the evidence thus far before the court. Tr. 67:63.

And the ability of [Liggett] to compete and to offer consumers a lower price or a lower price choice had been compromised. [B&W] recognized this in their own documents in evidence. Tr. 67:64.

the discrimination may have that effect. *See Corn Prods. Refining Co. v. FTC*, 324 U.S. 726 (1945).").

The same is true even under the more demanding tests of Sherman Act §2. While nearly all the circuits assess the market before finding a "dangerous probability" of monopoly, they usually make clear that conduct is to be judged at the time it was undertaken in the light of market circumstances as they then appeared to the actors. E.g., *Multiflex, Inc. v. Samuel Moore & Co.*, 709 F.2d 980, 992 (5th Cir. 1983), *cert. denied*, 465 U.S. 1100 (1984) (relevant time is "when the acts occur"; "hindsight" cannot "exonerate an antitrust violator who did cause damage to the plaintiff."); *United States v. American Airlines, Inc.*, 743 F.2d 1114, 1118 (5th Cir. 1984), *cert. dismissed*, 474 U.S. 1001 (1985) ("[W]e do not rely on hindsight but examine the probability of success at the time the acts occur.").³⁸

In short, the Fourth Circuit was wrong to think that the actual state of the cigarette market at the time of trial confirmed its "theoretical suspicion" that oligopolistic predation is impossible. Nor does the state of the market provide an alternative ground for disregarding the jury verdict.

³⁸ Even if consumers had not actually been injured, B&W's violation undoubtedly caused Liggett actual injury. Liggett's injury is "antitrust injury;" it is the kind that an antitrust law against predatory pricing is designed in the first instance to prevent in order to protect consumers from the ultimate harm of supracompetitive prices. *See Multiflex, Inc.*, 709 F.2d at 994 (plaintiff's injury is antitrust injury when it actually results from conduct that violates the antitrust laws because it is the kind of conduct that, if success "had materialized, would have caused the type of market damage the antitrust laws seek to prevent."); P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 340.2b (1992 Supp.).

CONCLUSION

The judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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Supreme Court, U.S.

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No. 92-466

IN THE
Supreme Court of the United States

OCTOBER TERM, 1992

LIGGETT GROUP INC.,
Petitioner,
v.

BROWN & WILLIAMSON TOBACCO CORPORATION,
Respondent.

On Writ of Certiorari to the
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for the Fourth Circuit

RESPONDENT'S BRIEF ON THE MERITS

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QUESTION PRESENTED

Respondent Brown & Williamson Tobacco Corp. respectfully submits that the "Questions Presented" identified by petitioner Liggett Group Inc. are not genuinely presented. The only question appropriate for resolution by this Court is:

Whether the Fourth Circuit correctly affirmed the district court's determination that Liggett failed to demonstrate factually the elements of its oligopoly recoupment theory of competitive injury.

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RESPONDENT'S BRIEF ON THE MERITS

COUNTERSTATEMENT OF THE CASE

Introduction

This case arose from an outbreak of price competition triggered by respondent Brown & Williamson Tobacco Corporation's ("B&W")¹ entry into an emerging product segment of the cigarette industry. This competitive challenge was countered by an immediate lawsuit by petitioner Liggett Group Inc. ("Liggett") to preserve its 97% control of the new market segment. The complaint was filed two weeks after B&W announced its plans to enter and before B&W had sold a single cigarette. The result of B&W's entry, and that of other cigarette manufactur-

¹ Pursuant to Rule 29.1, B&W states that it is an indirect wholly-owned subsidiary of B.A.T. Industries, p.l.c. Between B.A.T. Industries, p.l.c. and B&W are South Western Nominees Ltd. (U.K.), BATUS Holdings, Inc. and BATUS Tobacco Services, Inc. B&W has only wholly-owned subsidiaries.

ers, has been vigorous price competition in the entire cigarette market, a proliferation of discount brands and varieties of cigarettes, and consumer savings of hundreds of millions of dollars.

The version of the facts and issues given by Liggett is so misleading that B&W is compelled to restate the case from beginning to end.

This is a predatory pricing case brought under the Robinson-Patman Act by one competitor in the cigarette market against another competitor. Based on seriously defective instructions, the jury found for Liggett. J.A. 27-28.² The district court granted B&W j.n.o.v., Pet. App. 19a, 52a; J.A. 34-35, and a unanimous panel of the Fourth Circuit affirmed on the ground that Liggett had shown no reasonable possibility of injury to competition. Pet.App. 2a. On the sole issue before this Court, potential competitive injury due to oligopolistic predation, both courts below rested their decisions upon the evidence of record. *Id.* at 12a-13a, 32a-38a.

The dispute before this Court is also factual. The outcome of this case does not depend on the answers given to Liggett's "Questions Presented," which are not posed by the decisions below, but on whether the two courts below or Liggett correctly described what happened in the market.

Liggett claims that B&W engaged in predatory, below-cost pricing in order to discipline Liggett and force it to raise its prices. Pet.Br. 1-2. B&W, according to Liggett, planned to and did recoup its losses on below-cost prices and thus injured consumers, as it had also planned. Pet. Br. Questions Presented. Liggett states that B&W, despite its small 12% market share, was able to accomplish

² In this brief, Liggett's Petition for a Writ of Certiorari is cited as Pet. —; its Brief on the Merits is cited as Pet.Br. —. The Joint Appendix is cited as J.A. —. Exhibits admitted into evidence at trial are cited as PX or DX —; the official transcript from the district court is cited as Tr. volume:page. The opinions of the district court and court of appeals are cited as Pet.App. —.

this because it signaled other, much larger cigarette manufacturers not to interfere. *Id.* at 18. Liggett asserts that the other firms, acting not by agreement but as rational oligopolists, joined B&W in "managing prices upward." *Id.* at 2-3, 18-19.

Liggett's proof consists primarily of statements culled from B&W planning documents. Liggett claims that these documents show B&W's "intent" to "discipline" Liggett. B&W will show that Liggett's portrayal of an alleged B&W "plan" is an illusion created by distortions of the record, misleading quotations and misattributions, as well as by "splicing" of documentary fragments from different times and different organizational levels of B&W. Even Liggett's so-called "intent" documents do not support Liggett's case.

Apart from Liggett's abuse of the "intent" documents, however, the uncontested objective market facts are completely inconsistent with Liggett's assertion that B&W planned, attempted, or succeeded in any oligopolistic "signaling" scheme to stifle price competition. Thus, Liggett's heavy reliance on intent documents is beside the point, since such documents could at most show B&W's early hopes and plans, not its actual conduct and not the real-world effect of generic discounting on the explosion in cigarette market competition. As the district court found after comparing Liggett's version of B&W's "analysis" with the undisputed market realities, even "[a]n avowed predator with no prospect of controlling prices is a paper tiger unable to harm consumer welfare." Pet.App. 33a.

This counterstatement of the facts will demonstrate that (1) the jury did not "find" key "facts" asserted in Liggett's brief; (2) B&W neither intended to nor did price below cost; (3) B&W planned no recoupment and received none; (4) B&W gave no "signal" to rival cigarette manufacturers; (5) those rivals, far from showing oligopolistic restraint, competed vigorously, just as B&W expected; and (6) competition, far from being injured, intensified to the benefit of consumers.

A. Liggett's Reliance On Jury "Findings" Is Specious.

Given the trial court's defective instructions,³ it is improper to claim, as Liggett does, that the jury found either sales below cost or a likelihood of recoupment. The jury returned a general verdict on the issue of injury to competition (Issue 1). J.A. 27. There were no special interrogatories as to sales below cost, prospective recoupment, or any other element of the proof of injury to competition. *Id.*

Nor is it true to say, as Liggett does, that the jury's general verdict necessarily contained findings on these critical issues. The jury was instructed that, provided B&W had power in a submarket, the jury could base liability solely on documents indicating B&W's bad intent. Instr. 16, 18, 29, J.A. 831-35, 843. The instructions permitted, and the judge's subsequent explanation encouraged, the jury to find liability without finding any of the elements of competitive injury that Liggett claims were found. Tr. 123:27-30. Because the jury's factual findings are unknown and unknowable, the courts below did not substitute their view of the facts for any facts "found" by the jury. Indeed, since Liggett concedes that a competitive injury verdict based on predatory "motive" alone is untenable, Pet. 7 n.11, the jury verdict here fails for that reason alone. See *Spectrum Sports, Inc. v. McQuillan*, No. 91-10, slip op. at 12 (U.S. Jan. 25, 1993) (defective jury instructions vitiate antitrust verdict; predatory intent alone cannot support verdict of attempted monopolization).

1. The Jury Was Not Required to Find That B&W Priced Below Cost.

Liggett repeatedly asserts that the jury made the crucial factual finding that B&W priced below cost. Thus,

³ The errors in the trial court's instructions were the subject of B&W's conditional cross-appeal, seeking a new trial, in the Fourth Circuit. That court did not reach those issues. The instructions are discussed here only to show that what the jury might have found cannot be determined from its verdict.

Liggett states: "B&W priced its black-and-whites below their average variable cost." Pet.Br. 13. Liggett asserts that B&W was "proven" to have engaged in "actual below-cost pricing." *Id.* at 33 (emphasis Liggett's). Liggett states as fact that "B&W sold black-and-whites well below their average variable cost for 18 months." *Id.* at 39.

These statements are baseless. Liggett tried to prove sales below cost and B&W tried to disprove such sales. Nobody knows what the jury thought on these issues. The jury gave a general verdict on the issue of injury to competition. J.A. 27. It did not answer special interrogatories. Nor can Liggett properly argue that these crucial factual findings were "necessarily" implicit in the verdict. The jury instructions destroyed that possibility.

Thus, according to Instruction 16, J.A. 832, "*Alternative Methods of Proving*" competitive injury, Liggett could establish such injury "in either one of two ways," (1) through "market analysis" showing actual injury, or (2) by a showing of "predatory intent" from which competitive injury could be inferred. J.A. 833. In turn, under Instruction 18, J.A. 834, such predatory intent could be inferred "in either one of two ways," (1) from below-cost pricing or (2) from "direct" evidence of B&W's bad statements, documents, or conduct.⁴ In short, below-cost pricing was one of at least three alternative ways to show potential injury to competition.

Hence, not only was the jury not told that it must necessarily find such below-cost pricing, it was plainly told that it need not do so. Indeed, the trial court ne-

⁴ Such purportedly "conventional" double-inference instructions are repudiated by Liggett itself, Pet.Br. 43 n.55, and have been called "unnecessarily cumbersome and even misleading." Phillip Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 720'c, at 730 (Supp. 1992) ("*Antitrust Law* (Supp. 1992)"). Liggett grades them "satisfactory" here because they were ostensibly "supplemented" by requirements of below-cost sales and recoupment. Pet.Br. 43 n.55. But the instructions imposed no such requirements. See *infra* pp. 2-3.

glected to give any instruction requiring proof that B&W priced its generics to lose money, even though B&W had specifically requested such an instruction and the judge had agreed to it. Tr. 111:79; B&W Proposed Jury Instruction 19, J.A. 25. Therefore, Liggett's repeated assertions that B&W priced below cost are untenable.

2. The Jury Was Told That It Could Find Predatory Intent Solely From Bad "Statements" in B&W "Documents."

That the jury did not address the issue of below-cost pricing is all the more likely because of the court's detailed instructions on intent. The jury was instructed that it could find B&W had a predatory intent solely on the basis of statements of aggressive language in some B&W documents. Instr. 18 and 29, J.A. 835, 843. Thus, Instruction 18, J.A. 834-35, plainly informed the jury that it could find a "reasonable possibility of injury to competition" from "predatory intent," and that predatory intent "may be found through direct evidence of B&W's statements, documents or conduct." The only example of "conduct" the court offered was the knowing copying of Liggett's package design. Instr. 29, J.A. 843. This example allowed the jury to find predatory intent from unspecified varieties of bad "conduct" unrelated to below-cost pricing or recoupment.

Accordingly, it was entirely possible for the jury to think that B&W's bad intent documents or unspecified bad conduct *alone* established injury to competition inferred from predatory intent.

3. The Jury Instructions Did Not Require a Finding That B&W Had a Reasonable Prospect of Recoupment.

According to Liggett, "predatory intent was carefully defined. The jury was told that the *only* intent relevant to this case would be a B&W plan 'to discipline and exclude . . . rivals . . . so that it can earn higher than competitive profits. . . .'" Pet.Br. 20 (citing Instr. 19, J.A. 835) (emphasis added).

However, Instruction 29—*never mentioned by Liggett*—clearly states that a "second way" to "establish predatory intent" is from "direct evidence" of "oral or written statements by Brown & Williamson personnel." J.A. 843. This critical instruction on "*Direct Evidence of Predatory Intent*" does not mention below-cost pricing or recoupment, and it does not point the jury toward *any* objective evidence bearing on "recoupment." Instead, after explaining that "predatory intent" (and therefore competitive injury) could be found directly from bad documents or "conduct," the sole example of conduct given was the alleged copying of Liggett's packaging. Neither the instruction nor this example had anything whatever to do with recoupment. Thus, the jury was allowed to consider vague and undefined bad "conduct" as a basis for a predatory intent finding.

To overcome this fatal flaw in its assertion, Liggett maintains that "[t]he jury was warned not to infer injury to competition from predatory intent if its common sense indicated that there was no such possibility of recoupment." Pet.Br. 20 (citing and relying on Instr. 12 and 20, J.A. 829, 835). But No. 12 defines injury to competition generally, including a reference to recoupment, without mentioning predatory intent. And No. 20 is a boilerplate cautionary instruction defining "inferences" and urging "common sense," which does not mention recoupment. Liggett stitches these two instructions together to falsely claim that there was a specific warning on recoupment. There clearly was no such warning.

Hence, Liggett is incorrect to suggest that the jury must have found prospective recoupment by B&W. Instruction 29 plainly allowed a verdict for Liggett without (in Liggett's words) proof of "a recoupment potential" or finding recoupment "a genuine prospect here." Pet.Br. 41.

4. The Court Instructed the Jury on a Submarket That Was Not Even in the Case, Allowing the Jury to Find B&W Liable on the Basis of Power in a Nonexistent Submarket.

Finally, the trial court *sua sponte* injected the concept of submarkets into this case after the evidence was closed and over the objections of counsel for both parties. These instructions, too, make it impossible to know what the jury found. The very first instructions on competitive injury repeatedly stressed the "importance" of the separate concepts of markets and submarkets. Instr. 6, 7, 8, 9, J.A. 824-28. The jury was then told it could find injury to competition in the market as a whole if B&W had bad documents and power in a "well-defined submarket of generic cigarettes." Instr. 13, 14, 19, 29, J.A. 830-32, 835, 843.

The jury was so instructed despite the parties' stipulation that the relevant market comprised all cigarette sales, branded and generic, Pet.App. 25a, and Liggett's counsel's protest that he had not tried the case on any submarket theory, Tr. 112:85-86. The district court itself recognized in granting j.n.o.v. that the instruction had been improper:

The parties have stipulated that the relevant market is the entire cigarette market in the United States. Upon close examination, this court believes that there is no substantial economic evidence that generic cigarettes are sufficiently distinct from branded cigarettes to justify applying the average variable cost test to generic cigarettes alone.

Pet.App. 25a (footnote omitted). Though it thus decided in its j.n.o.v. opinion that there was no valid submarket in this case, the district court had emphasized the submarket in ten separate instructions (Instr. 6, 7, 8, 9, 13, 14, 19, 21, 22, 24, J.A. 824-40) on the very issue now before this Court—injury to competition.

Nor were the instructions harmless. The district court itself stated that the submarket issue was indispensable

to Liggett's case. When even *Liggett's* counsel protested the proposed instructions, the court said: "Mr. Hogeland, you wouldn't even be here if it wasn't in this case. You wouldn't have gotten past summary judgment if it wasn't in the case." Tr. 112:85.

Later, of course, the j.n.o.v. opinion removed the submarket issue from the case, but that cured nothing because the issue *was* in the case when the jury deliberated.

5. The Court's Subsequent Explanation to the Jury Stressed the Intent and Submarket Issues.

The prejudicial impact of these instructions was magnified by the trial judge's confusing response to the jury's request for "help" on day 8 of its 10-day deliberations. Tr. 123:7, 27-30. Although having the lengthy written instructions before them, J.A. 813-51; Tr. 115:11, 141-42; Tr. 123:25, the jury's note to the judge said that "some of the instructions" were "sort of unclear to us at this time," Tr. 123:8. The judge stated that the competitive injury instructions "may be confusing" on the relationship of market power and intent. Tr. 123:10-11.

The court's explanation to the reconvened jury invited a verdict based on B&W's "bad intent" alone. Tr. 123:27-30. Thus, in explaining two "alternative methods of proving reasonable possibility of injuring competition," the judge elaborated on finding competitive injury based on bad intent, but mentioned neither below-cost sales nor recoupment. Tr. 123:29-30. Indeed, the judge's explanation reiterated the "importance of market power," including the "very important" determination as to "whether price value cigarettes are a well-defined submarket of the cigarette market." ⁵ Tr. 123:28-29.

* * * * *

⁵ Such simultaneous market/submarket instructions have been called "submarket confusions" that "have confused the legal issue by assuming that a 'market' and a 'submarket' could simultaneously be relevant to the appraisal of a particular transaction . . ." Phillip

The upshot is that, under the trial court's instructions, the jury may have found B&W liable (1) without finding any below-cost pricing, (2) on the basis of bad "intent" shown by statements alone, (3) without finding prospective recoupment, and (4) in reliance on a nonexistent generic cigarette "submarket." *Absolutely nothing about the elements of proof of competitive injury can be inferred from the jury's general verdict on that issue.* Thus, this case must be decided on the facts of record. Four federal judges have concluded that the facts relating to competitive injury do not support Liggett's claim. B&W will show that the judges were correct.

B. The Facts Demonstrate Legitimate, Aggressive Market-wide Competition That Benefited Consumers.

The facts demonstrate that B&W's entry into the generic segment of the cigarette market was part of a competitive process that brought all cigarette manufacturers into generics, increased price competition in both branded and generic cigarettes, and saved consumers hundreds of millions of dollars. The generic segment of the market not only grew during all relevant time periods, it is still growing today, with many generics priced much further below branded cigarettes than was the case when Liggett and B&W first engaged in head-to-head generic price competition.

1. The Parties and the Market.

Liggett and B&W, along with all other companies in the market, manufacture and sell cigarettes, both branded and generic.⁶ Pet.App. 20a, 22a. The parties stipulated

Areeda, *Monopolization, Mergers, and Markets: A Century Past and the Future*, 75 Cal. L. Rev. 959, 979-80 (1987).

⁶ This brief defines "generic cigarettes" as (1) black-and-white cigarettes—sold in nondistinctive packaging at a low price; (2) private-label generics—sold at generic prices with the name and trade dress specified by the purchaser (usually a retail chain); (3) branded generics—cigarettes with name-brand identity (e.g., "Doral"), but sold at discount prices; and (4) "Value-25s"—sold in packages of 25 cigarettes at the regular price of 20-cigarette packs.

that the relevant market consists of all cigarettes sold by the domestic industry. *Id.* at 25a. There are four other competitors in the industry: Phillip Morris ("PM"), R. J. Reynolds ("RJR"), Lorillard, and American. *Id.* at 2a-3a, 20a n.7. PM and RJR are the industry leaders, with 41.9% and 28.5% market shares, respectively, at the time of trial. J.A. 352. B&W was a distant third and its market share never exceeded 12% at any relevant time. Pet.App. 3a, 33a. Both Liggett and B&W have at all times been profitable full-line competitors. *Id.* at 48a. During the relevant time period, both companies were backed by multibillion dollar British parents. J.A. 212; Tr. 8:137-38; Tr. 27:91-92; Tr. 62:19.

Far from being the "stable oligopoly" portrayed by Liggett, Pet.Br. 6, the industry has experienced profound changes. PM rose from last place to oust RJR from first place in 1984. DX 3502R; Tr. 100:164. Liggett, once "a major factor in the cigarette industry" with market share over 20%, slid "precipitously for many years" down to last place since 1980. Pet.App. 21a. B&W fell from 17% in 1975 to 10.9% by 1988. DX 3502R. Even as those dramatic changes occurred, slumping overall demand created industry-wide excess capacity. J.A. 84. These are the classic conditions that make price competition inevitable.

Price competition increased in importance well before the introduction of generics. The very B&W planning documents cited by Liggett recognize that the entire cigarette market had grown increasingly price-competitive. List prices⁷ were losing significance because manufacturers had begun offering discounts directly to consumers through coupons, stickers (manufacturers' coupons placed on cartons displayed on retailer premises) and promotions (free product to purchasers of branded cigarettes). PX 4 at 12; Tr. 2:198-99. But price competition was about to escalate into a price war.

⁷ All references to list prices mean announced prices to wholesalers, retailers and other market intermediaries. Cigarettes are never sold by manufacturers to consumers (smokers).

2. The Evolution of Discounting and the Explosion of Industry-Wide Price Competition.

a. The origin of generics.

At the request of a grocery store purchasing group for its own private-label cigarette, Liggett began to produce generics in 1980. Pet.App. 21a. Eventually, Liggett offered its own black-and-white cigarettes with volume rebates, displacing two companies that had pioneered black-and-white generic cigarettes.⁸ *Id.* at 21a & n.10.

RJR was the first to respond, in July 1983, with a generic Value-25 brand, "Century." *Id.* at 3a. In addition to offering a brand, 25s sold at a considerable discount from full-price brands. B&W followed shortly thereafter with its own 25, "Richland." *Id.* There were thus three sellers of generic cigarettes in the market by the end of 1983. By 1984 generics constituted 4% of the market and Liggett sold 97% of generics. *Id.* at 21a.

Because its own branded sales were eroding as generics grew, B&W began planning new discount entries. *Id.* at 3a-5a. It investigated the possibility of manufacturing three varieties of generics—branded, private label, and black-and-white—in late 1983. *Id.* The written record of that process shows an entirely different reality from Liggett's version.

B&W foresaw that the generic segment would continue to grow. PX 4 at 21. "The future growth of generics will be driven by consumer demand—not by the number of manufacturers who supply those products." J.A. 102. B&W anticipated that its competitors would enter the generic segment. J.A. 75-77, 103. "A competitive response appears to be inevitable and we strongly feel B&W will be better off being second rather than third or fourth." J.A. 103.

⁸ Generic cigarettes were first introduced by G.A. Georgopulo & Co. (a cigarette importer and small manufacturer) and U.S. Tobacco Co. (a maker of smokeless tobacco products and former cigarette producer). Pet.App. 21a n.10.

b. RJR's repricing of Doral as a generic.

On April 27, 1984, RJR, one of the two industry leaders, cut the list price of Doral, then a full-price brand, to the same list price as Liggett's black-and-whites, and offered volume rebates equal to or greater than those offered by Liggett. J.A. 110. RJR first cut Doral prices in the fourteen states where Liggett's black-and-whites were most successful. J.A. 209-10. On June 22, 1984, less than two months later, RJR extended the same prices and rebates on Doral nationwide. *Id.* The RJR executive responsible for repositioning Doral testified that volume incentives were "a very critical part of our plan, given the fact that Liggett had a similar type of program. We felt it was necessary to gain distribution and to create an incentive for volume purchases." Tr. 104:177.

c. Doral radically changed the marketplace.

RJR's repricing of Doral accelerated B&W's planning. After extensive analysis, B&W made its final recommendations to its then parent company, BATUS, on May 15, 1984 ("Final Proposal"). B&W's Final Proposal, relied upon by the Fourth Circuit, expressly stated that prior speculations were now obsolete:

The earlier concern of expanding the economy segment is no longer tenable, given RJR's recent action. It is clear that the economy segment is significant and growing.

Accordingly, recognizing the importance of minimizing increased cannibalization and concomitant share erosion, as well as maintaining trading profit targets, it is imperative that B&W enter this segment.

J.A. 141 (emphasis added).⁹

⁹ B&W's Final Proposal was based on a series of "Strategic Conclusions," e.g.: "1. The economy segment has established itself in the U.S. market and will be a major part of the market in the foreseeable future." and "2. A declining total market in combination with growth in the economy segment makes a strong competitive response inevitable." J.A. 130-31.

The Final Proposal's prediction that the generic segment of the market was here to stay and would continue to grow was fundamental to B&W's planning. B&W believed that:

branded generics will enhance the growth of the economy segment and will draw volume from popular priced brands. B&W believes that the black and white/private label generics will continue to be a large and viable subsegment of the total economy segment.

J.A. 130-31.

B&W's Final Proposal assumed that: "The economy segment grows to 10% of market by 1988. It was further assumed that two-thirds of this segment would be represented by black and white/private labels and one-third by branded generics." J.A. 133. The Final Proposal also projected that the percentage price difference between generic and full-price brands would remain at its then-current level (35%) throughout the balance of the five-year planning period. J.A. 153, 156.

B&W's Final Proposal attempted to anticipate the strategies of other cigarette manufacturers, but assumed (correctly) that such strategies would differ. Thus, "RJR has clearly stated its willingness to live with lower margins on volume *it otherwise would not have enjoyed.*" J.A. 136. B&W thus recognized that RJR would accept low Doral prices indefinitely. B&W speculated that PM would probably launch a branded generic if Doral succeeded, J.A. 136, that "Lorillard will be the next company to enter this segment," (it was actually the last), and that "American is not expected to respond given its history of being the last in the industry to recognize new consumer trends." J.A. 136. Contrary to Liggett's picture of an oligopoly in which each company knew what the others would do, B&W was unsure of its competitors' reactions.

B&W's Final Proposal therefore recommended the introduction of black-and-white generics and a branded generic to be known as "Hallmark." BATUS vetoed

Hallmark, however, because it would have taken too long to become profitable. J.A. 694. BATUS approved B&W's proposal to sell black-and-white cigarettes. J.A. 442. BATUS insisted that B&W's black-and-white cigarettes be priced to make a profit from the outset. J.A. 442; Tr. 33:102-12. B&W proceeded in accordance with these directions. J.A. 176.

B&W announced its intention to sell black-and-whites as well as its prices and volume rebates on May 31, 1984. Liggett concedes that these volume rebates, similar to its own, resulted in B&W prices above cost. J.A. 622, 704. Liggett, however, immediately increased its volume rebates. J.A. 201-06, 212; Tr. 69:116. Between late May and July 19, 1984—before B&W had sold any black-and-whites—Liggett and B&W engaged in five rounds of increased rebates. Pet.App. 22a. Every one of these rebate increases was initiated by Liggett. J.A. 201-06.

The evidence is clear that before every volume rebate increase, Tony Bacon, B&W's controller, calculated that B&W would make money on generics. J.A. 194-95, 694-706; Tr. 93:139-47. He also testified that during the planning period, he never did a financial projection with a branded/generic price spread less than 30%, Tr. 92:118, and that neither he nor anyone else in his department (finance) was asked to make any projections on the assumption that the growth of the generic segment would slow. Tr. 92:119.

d. *Cigarette discounting and competition have grown explosively since B&W's entry.*

Cigarette discounts have proliferated and increased since B&W's announcement. By time of trial, five of the six manufacturers offered discounts of at least 50% off full-price cigarette brands (two of these firms offered their black-and-whites at these low prices). J.A. 681-86; Tr. 107:147. Meanwhile, the economy segment has grown from 4% of the market in 1984 to 15% at time of trial and over 31% of the market today. *Maxwell Consumer*

Report, Third Quarter 1992 Sales Estimates for the Cigarette Industry, at 4 (Oct. 30, 1992) ("*Maxwell Consumer Report*").¹⁰ Black-and-whites alone accounted for over 17% of the entire market at the time of the last authoritative industry report. *Id.*

Total industry sales of generics went from 2.8 billion cigarettes in 1981 to 61.6 billion in 1988 and then to nearly 80 billion at the time of trial—more than a twenty-eight-fold increase. Pet.App. 6a, 12a. RJR executive Winebrenner agreed that competition among Liggett, RJR and B&W brought lower net prices to distributors, retailers and consumers. Tr. 105:18. Indeed, "[t]he growth of generic cigarettes has encouraged additional competition, primarily in the form of couponing and stickering, on branded cigarettes."¹¹ Pet.App. 22a-23a (footnote omitted). Even Liggett's economics witness agreed that generic cigarettes exercised a "downward influence or drag on the prices of branded cigarettes." Tr. 52:23, 24; Tr. 51:115, 180. Liggett's director of national sales confirmed that consumer savings attributable to discounting had risen nearly ten-fold after B&W's introduction of its black-and-whites, from \$375 million in 1980-84 to almost \$3.5 billion from 1984-89. Tr. 44:116-18.

C. Undisputed Market Facts Refute Liggett's Story.

Contrary to Liggett's imaginings, the record shows that B&W did not plan to injure competition and did not do so. Liggett has constructed a superficially powerful story for this Court by pasting together statements from B&W

¹⁰ Although Liggett protests the use of the *Maxwell Consumer Report* as "post judgment non-record evidence," Reply Br. in Support of Petition at 9, Liggett does not and cannot contest the accuracy of any of the data therein. Maxwell Consumer Reports have long been relied upon as the standard source of U.S. cigarette industry market statistics. They were consistently relied upon at trial by both parties for this precise purpose.

¹¹ Liggett protests that generics "obviously did not provide an effective brake" on market prices. Pet.Br. 18. However, every sale of a discounted cigarette puts a "brake" on market prices by reducing demand for full-price brands.

documents generated at different times and in different levels of the company. When these statements are put into context and in their proper temporal sequence, they tell a very different story than the one Liggett has made up. Instead, both the documents and, more importantly, the undisputed objective market facts show a vigorous competitive response to Liggett that increased competition and benefited consumers.¹²

1. Liggett Makes Its Case by Presenting Pre-Doral Conjectures as Post-Doral Policies.

Thus, for example, Liggett seizes on two phrases in a rough, handwritten note by a Ms. Tharaldson, J.A. 61, a seventh-tier (two from the bottom of the sales hierarchy) manager, PX 27; Tr. 2:198-99, that B&W could "signal" to competition that it would not expand the generic segment and wished to "put a lid on" Liggett. Ms. Tharaldson's note, of a meeting to develop options for management, is transformed by Liggett into "B&W memoranda" concerning corporate policies. Pet.Br. 2, 10, 16, 17, 18, 28, 31. It is even more egregious that Liggett takes this single, handwritten note made in early 1984, *before* RJR's repricing of Doral mooted all of B&W's prior specula-

¹² Like any firm in the midst of intense competition, Liggett's own documents are replete with dramatic characterizations of its competitive intentions regarding generic cigarettes. Liggett's plans indicated an intent to "lock[] out our competition" (DX 34R at 4; Tr. 69:191), "bury" competitive efforts (Tr. 12:182, 189), "wipe out" (Tr. 5:75-76) and "eliminate" competitors (Tr. 5:81-84; Tr. 12:86-88), "drown out demand" for their products (Tr. 6:48, 55), "limit competitive entries" (DX 320 at 25; Tr. 68:32-33), "thwart introduction of generic cigarettes" by B&W (DX 419 at 2; Tr. 68:32-33), "neutralize competitive entries" (PX 3692 at 3; Tr. 44:180-81), "blunt all effort of competitive entries," "hold competition at bay," and "lock out competition" (DX 2009 at 4, 5, 14, 16; Tr. 68:32-33). Liggett's documents reveal plans to "kill all B&W generic sales" (DX 2622 at 1; Tr. 85:55), "make every special effort to see that [customers] drop [B&W generics]" (DX 768 at 1; Tr. 84:106), "combat B&W's entry" (Tr. 100:40), "stop direct accounts from accepting . . . B&W generics" (DX 472 at 1; Tr. 68:32-33), and "conquer [B&W]" (DX 3544 at 4; Tr. 84:165).

tions, and converts it into a high-level corporate decision made *after* the repricing of Doral.¹³ *Id.* at 18, 31.

Liggett states that "B&W's goal was *first*, in its own words, to 'prevent[] an increase in the [generic/branded price spread]' and *then* to 'gradually reduce[]' that spread. J.A. 70-72, 280." Pet.Br. 11 (emphasis Liggett's). This is Liggett's effort to show that B&W entered generics while planning to reduce the "spread." But the quotation in the first half of the sentence is from a February 1984 *pre-Doral* document, while the second phrase is from an August 1985 *post-Doral* document, after B&W had been selling generics for over a year, when the spread had increased to almost 40%. J.A. 325. Moreover, the post-Doral document is not a statement of "B&W" corporate policy, but footnotes to an attachment to an internal solicitation for input to an impending five-year business plan. Such documents are hardly a "high level" or "sophisticated" corporate "analysis." Pet.Br. Questions Presented, 17, 43 n.56. B&W's corporate policy was reflected in its Final Proposal to BATUS, which projected that the branded/generic price "spread" would remain at 35% for the entire five-year planning period. J.A. 153, 156.

These documents do not set out any strategy of predation followed by recoupment from branded sales but an entirely normal thinking-through of the consequences of entering or not entering generics. There is no mention of selling below cost, discipline, or any other element of Liggett's "oligopolistic disciplinary pricing" scenario. There is no support in any B&W document for any plan of the sort Liggett describes.

2. The Evidence Contradicts Oligopolistic Behavior in Generic Cigarettes.

Liggett's own economic theory witness, William Burnett, conceded that the alleged oligopoly scheme could not

¹³ Contrary to Liggett's attribution of these notes to Ms. Olges, B&W's Director of Strategic Planning, Table of Contents to Joint Appendix, J.A. ii, the testimony is clear, and Liggett knows, that these are Ms. Tharaldson's notes. Tr. 23:106.

succeed if B&W's competitors were motivated to expand generics. Tr. 54:111. Yet, Burnett destroyed Liggett's case when he testified that, while there was tacit collusion on branded cigarettes, there was no tacit collusion in the generic segment during the alleged period of predation. Pet.App. 36a; Tr. 54:107. But Liggett's theory requires such collusion. Without tacit collusion, B&W could not, as alleged, discipline Liggett in the generic segment with confidence that the other companies would refrain from entering and expanding the segment themselves. Moreover, Burnett testified that RJR's repricing of Doral was independent of B&W and caused the expansion of the generic segment. Tr. 55:15-16; Tr. 51:128. But B&W could not succeed with its alleged plan without the tacit cooperation of RJR. Liggett's expert destroyed Liggett's theory.

Liggett's senior executives also demolished Liggett's theory. Liggett's president specifically denied that the industry is a "collusive oligopoly," J.A. 623, and testified: "The public has not been denied the benefits of free and open competition in the cigarette industry." J.A. 394. Liggett's senior vice president for sales and marketing also denied that the firms engage in "tacit collusion." Tr. 11:170-74. A former Liggett director disclaimed "tacit collusion," Tr. 64:53-54, and affirmed that cigarette prices are "competitive prices" determined by the market.¹⁴ Tr. 64:52.

Tacit collusion in the branded segment is also essential to Liggett's theory of predation in generics. If, as the executives entitled to speak for Liggett swore, there is no tacit collusion in branded cigarettes, there are also no supracompetitive profits that Liggett's theory of re-

¹⁴ Liggett's current attempt to walk away from the fatal admissions of its senior executives, Pet.Br. 7 n.11, is the last in a long series. B&W respectfully refers this Court to the district court's thorough and accurate analysis of Liggett's evasive positions. Pet.App. 34a-35a.

coupment requires.¹⁵ Again, Liggett put witnesses on the stand that destroyed Liggett's theory.

It is also noteworthy, in this supposedly tight oligopoly whose members can allegedly read each other's minds, that there are no documents, or any other evidence, showing that any of the other four cigarette manufacturers understood B&W to be disciplining Liggett or trying to contain the generic segment. Liggett took extensive depositions of PM and RJR executives and obtained their relevant business documents by subpoenas. If Liggett's scenario bore any relationship to reality, there would be evidence of that fact in the testimony or documents of those companies.

The most Liggett can do is its baseless claim that a "Reynolds executive testified that, by 1987, the industry was managing generic prices and profitability upward." Pet.Br. 18 (citing J.A. 758-59). But this RJR testimony says nothing about "generic prices." Instead, the RJR witness agreed with an independent industry analyst that "the industry is carefully watching and controlling its profit margins and making significant strides and [sic] improving the profitability of the lower-priced segment as it becomes a more important contributor to sales." J.A. 758-59.

¹⁵ Although cigarette industry profitability (including Liggett's) remained high in the 1980's, it was inflated by accounting conventions that excluded the value of brands from the asset base. Tr. 100:217-21 (testimony of Dr. Kenneth Elzinga). Also, those profits reflected the risk factor of an industry with rising regulation and litigation. Tr. 100:208-12. Specific firms may enjoy high accounting profits due to the success of individual brands, but this has no connection to oligopoly. Lacy Thomas, *Advertising in Consumer Goods Industries: Durability, Economies of Scale, and Heterogeneity*, 32 J.L. & Econ. 163, 188-89 (1989). Indeed, scholars observe that the cigarette industry has "at least a moderately high level of competition. . . ." Daniel Sullivan, *Testing Hypotheses About Firm Behavior in the Cigarette Industry*, 93 J. Pol. Econ. 586, 586 (1985).

3. *B&W's Volume Rebates, Used by Every Company Then Offering Generics (Including Liggett), Did Not "Signal" That B&W Was Constraining Generics.*

B&W's volume rebates are said to have been a signal that B&W was going to discipline Liggett but not expand the generic segment. But Liggett used volume discounts even when it was the only firm selling generic cigarettes.¹⁶ Pet.App. 21a. RJR repriced Doral with volume rebates to meet Liggett's volume rebates before B&W even announced that it would sell black-and-whites. Tr. 104:177. Why would competitors read B&W's rebates as a "signal" when both Liggett and RJR had already used volume rebates on their own generics?

The signal B&W actually sent—that it intended to compete and thereby expand the segment—was conveyed by B&W's offer to sell generics to one thousand wholesale customers who had never previously purchased generics. Tr. 87:191; Tr. 88:143, 146-47, 230, 233; PX 4079; Tr. 40:8-9. B&W reinforced that signal by investing \$10 million in stickering on its generics during the alleged period of predation. Tr. 70:246. *See also infra* p. 27.

4. *B&W Did Not Intend to Price Below Cost.*

The evidence about pricing is far different from Liggett's misrepresentation of it. Though it is clear that B&W did not actually suffer losses on its generics, Liggett concedes that the controlling question is whether B&W set its prices while reasonably anticipating that it would do so. Pet.Br. 20. The evidence is similarly clear that every B&W pricing decision was made with the expectation of a profit on its generics. *See supra* p. 15.

Liggett makes much of the fact that B&W planning documents indicate a willingness to price as low as "full variable margin." Pet.Br. 14. Liggett makes the un-

¹⁶ Liggett purports to find evidence of predatory intent in B&W's statement that volume discounts would "[p]ut the money where the volume is." Pet.Br. 26. Volume rebates always put the money where the volume is.

qualified assertion that "B&W's controller admitted that if B&W sacrificed full variable margin, it necessarily would have a negative trading profit." *Id.* Mr. Bacon actually testified that the terms "full variable margin" and "net variable margin" are *not* terms used by B&W's finance department, that they are used inconsistently in various B&W documents, and that he could interpret them only if they were tied to a financial schedule. Tr. 98:56; Tr. 92:121-22. The statement quoted by Liggett responded to a hypothetical posed by Liggett's counsel. Tr. 98:86-99. When questioned by the court in connection with the use of the term in B&W's Final Proposal, Mr. Bacon explained that "full margin," as used in the text of that document, "would suggest break even at trading profit, because that's what the financial schedule says."¹⁷ Tr. 98:64-65.

This "financial schedule," attached to B&W's Final Proposal, showed zeroes at the "Trading Profit" level. J.A. 153. This demonstrates that the Final Proposal's reference to the possibility of spending full margin means breaking even, not selling below cost.¹⁸ Tr. 98:64-65, 151;

¹⁷ Liggett purports to extract a concession from a B&W economic expert that B&W "priced" below cost. Pet.Br. 13-14. At most, the quoted excerpt says that for a time period artificially selected by Liggett, *ignoring* substantial tax savings that were actually *considered* by B&W in planning its introduction of black-and-whites, B&W's actual generic revenues would have been below its costs. In short, Liggett converts an answer to a leading question about a hypothetical *ex post* calculation into a concession of fact about B&W's pre-entry planning.

¹⁸ That B&W's sales planners routinely used variable margin to mean profits is established by other planning documents. Thus, a March 9, 1984 document, J.A. 81, suggests that Liggett may meet competitive entry in generics by "spend[ing] down to full variable margin (i.e., zero profit)." J.A. 91. "If L&M goes below full variable margin, Brown & Williamson would not plan to match their offer. We would not expect L&M to be able to maintain a loss position for any extended period of time." J.A. 92. This was a plan by B&W *not* to sell below cost even if Liggett did.

That the intention of the Final Proposal was *not* to lose money on generics is further established by the statement that if B&W

Tr. 30:74. Liggett, which had the Joint Appendix printed, has converted the financial schedule's zeroes to asterisks, stating that the figures are illegible. J.A. 153. This financial schedule was a subject of Bacon's testimony at trial, and it was clear to Liggett's counsel then,¹⁹ as it should be to Liggett's counsel now, that the bottom line figures are zeroes.

5. B&W Did Not in Fact Sell Below Cost.

The after-the-fact calculation of Liggett's economist, Burnett, that B&W sold below cost ignores an important source of cost savings that B&W realized because of tax reductions due to additional sales volume and its LIFO accounting system. B&W took these into account in its Final Proposal. J.A. 147-49. Under LIFO, which is a widely used and legitimate accounting system, B&W made cigarettes with older tobacco that had been bought at lower prices but deducted from revenues the cost of the most recent, higher-priced tobacco. This resulted in higher profits because of the tax savings. There was a dispute at trial whether higher returns due to tax savings should be used in an antitrust case to show that a product line was profitable. Whatever antitrust law ultimately says on that point, it is indisputable that B&W at the time thought this was a proper calculation and, therefore, that it would not be losing money on generics.

If the higher return from generic sales due to tax savings is counted, as it should be, B&W clearly did make

gets the business with the suggested price, "competitors will not be able to make their proposals meaningfully more attractive without selling below cost. Competitive response of this nature would be considered unlawful conduct." J.A. 145.

¹⁹ "Q. [By Mr. Topman, Liggett's counsel]: So in May in '84, Mr. McCarty gets the May proposal and it shows trading profit on the last line of the schedule as zero, right, sir?

A. [By Mr. Bacon]: The last line on the schedule shows zero." Tr. 98:151. *Accord* Tr. 98:148-50.

In addition, when questioned by another Liggett attorney, B&W's president, Tommy Sandefur, testified: "Those zeroes mean break even." Tr. 30:124. *Accord* Tr. 30:74.

very substantial profits on its generics. Liggett's economic witness, Burnett, conceded that if tax savings were counted, B&W's generic sales were profitable. Tr. 57:130-36. Ignoring tax savings, B&W's generic revenues for the 18-month period arbitrarily selected by Liggett fell \$1.2 million short on sales of over \$190 million—less than 1% short of break even. Tr. 92:95-96; Tr. 93:181. Contrary to Liggett's contention, there was also no 18-month period of continuous below-cost pricing. Even if the tax savings are ignored, B&W made profits on black-and-whites in seven scattered months of that period and its black-and-whites were profitable when viewed over the 24-month period following their introduction. Tr. 92:95-96; Tr. 93:181; DX 1469; Tr. 93:185, 198; DX 3510; Tr. 93:167. However the tax question may be resolved, one thing is abundantly clear: B&W did not anticipate that its generic prices would be below cost and did not anticipate losses on generics. That is the dispositive fact.

6. B&W Had No Plan to Recoup Any Losses on Generic Sales.

Liggett concedes that the courts below were correct in holding that Liggett had to show that B&W had a reasonable expectation of recoupment. Pet.Br. 23-24, 41. Liggett's expert witness testified that predation made no sense without the expectation of recoupment. J.A. 480-81. Liggett's counsel has written that predatory pricing would make little economic sense without "a very substantial prospect that the losses [the predator] incurs in the predatory campaign will be exceeded by the profits to be earned after his rivals have been destroyed." 3 Phillip Areeda & Donald Turner, *Antitrust Law* ¶ 711b, at 151 (1978) ("*Antitrust Law* (1978)").

Liggett relentlessly repeats the charge that B&W offered black-and-whites pursuant to an express plan to "recoup" its losses from alleged predatory pricing.²⁰

²⁰ See Pet.Br. Questions Presented; Pet.Br. 1, 5, 9, 17, 28-29, 33, 37, 41, 42, 43, 44, 45.

Thus, in addition to the instances cited in the footnote, Liggett baldly claims that "B&W calculated that it alone would benefit enough—up to \$350 million by 1988—to make its investment in disciplining Liggett pay off handsomely." Pet.Br. 28-29.

On the contrary, the \$350 million is a pre-Doral estimate of the profit B&W would lose if it did not go into generics. J.A. 81, 83. For that reason, the document recommended entering the generic segment:

Generics represent B&W's most immediate opportunity to increase volume. This volume can be achieved within current manufacturing capacity, without incremental manpower and *without negatively impacting trading profit*. No other option offers similar potential to recover lost volume/share with such minimal investment risk.

J.A. 88 (emphasis added).

B&W's Final Proposal to BATUS also makes clear that B&W planned to recover profits lost on branded sales with the profits it expected to make on black-and-white sales from 1984 to 1988. J.A. 146. That conclusively rebuts Liggett's claim that B&W intended to lose money on black-and-whites in order to recoup on branded sales.

- a. *Liggett did not "surrender" by raising its prices and closing the "spread" between branded and generic prices.*

Liggett's story about "surrendering" and narrowing the "spread" between the list prices of its branded and black-and-white cigarettes is equally baseless. Liggett did not "surrender" and the "spread" between branded and generic prices did not narrow but widened.

Liggett did not "surrender" to B&W. In March 1984, before RJR's Doral announcement and before B&W's black-and-white announcement, Liggett on its own increased black-and-white list prices, closing its spread from

40.82% to 35.68%. J.A. 325. Liggett surrendered before it had anybody to surrender to.

In June 1985, when Liggett claims it surrendered by raising its black-and-white prices, it simultaneously boosted its rebates to many of its largest customers.²¹ Thus, the alleged June 1985 "surrender" was largely a function of Liggett's bookkeeping. Indeed, following this unilateral generic price increase, Liggett persuaded distributors to raise the prices of B&W's black-and-whites and RJR's branded generic, Doral. J.A. 264-65.

The district court correctly held that B&W's *only* attempt to initiate a generic price increase, in December 1985, had to be retracted promptly because Liggett and other producers did not follow. Pet.App. 38a n.36. Liggett's assertion that it "followed" B&W increases in 1986, 1987 and 1988, Pet.Br. 16, is simply made up in contradiction of the record. If Liggett easily "resisted" B&W's attempted increase at the very end of the alleged "period of predation," *id.*, why would it "follow" B&W increases thereafter? Indeed, Liggett later introduced "Pyramid" at a 50% discount.²² *Id.* at 18 n.20.

In short, the one time Liggett initiated a price increase, B&W was not yet selling black-and-whites. The one time B&W initiated a generic price increase, Liggett did not follow.

Liggett's contentions about the gap shrinking from 40% in 1985 to 26.8% in 1989, Pet.Br. 18, are equally fanciful. Liggett's gap calculations are based on the differences in list prices between its own branded and generic cigarettes. Even on these terms, the calculation is spurious, because it ignores the array of discounts, rebates, and promotions that made list prices meaningless. As

²¹ DX 1416; Tr. 85:196-97; DX 1417; Tr. 85:177; DX 2428; Tr. 85:185; DX 2429; Tr. 85:202; DX 8732; Tr. 104:21-22; Tr. 85:179.

²² Liggett asserts that B&W allowed it to sell at a 50% discount because B&W was intimidated by the lawsuit. Pet.Br. 18 n.20. But this lawsuit was pending during the entire period of alleged predation.

B&W's economic expert, Dr. Elzinga, testified, cigarette list prices do not reflect a wide variety of other forms of price competition, including coupons, stickering, rebates and other promotional programs. Tr. 100:227-29. Coupons alone account for "hundreds of millions of dollars" annually. Tr. 33:206-09. Again, taking the calculation on its own terms, as early as 1982, Liggett itself had projected that it would decrease its gap to 24.2% by August 1985, and indeed, raised its price in March 1984, reducing the gap by 5%. DX 36R; Tr. 68:162-63; J.A. 325.

But Liggett's gap calculations cannot be taken on their own terms. Liggett myopically focuses on its own black-and-whites, ignoring not only others' branded generics, but also ignoring its own branded generic, Pyramid, that widened the gap to over 50% in 1988. Indeed, by the time of trial, five manufacturers offered cigarettes at a discount of at least 50%. J.A. 681-86; Tr. 107:147. Two of these were black-and-whites. *Id.*

b. *B&W never "took credit for slowing the growth" of generics.*

Not only did B&W not take "credit for slowing the growth of disruptive generics," Pet.Br. 3, there was nothing to take credit for. As demonstrated *supra* pp. 15-16, the growth of generics was explosive.

Liggett points to a B&W document, J.A. 257, which does not say that "the growth" of generics has slowed but that the "growth rate" of black-and-whites has slowed. Pet.Br. 3. As the growth of black-and-whites continued, the rate of growth necessarily slowed because of the larger base against which growth was measured. Liggett points out that the document also states that B&W's presence in black-and-whites reduced Liggett's advertising. *Id.* at 12. Of course that was true. Nobody would spend to advertise black-and-whites when much of the benefit would go to a competitor's virtually indistinguishable black-and-whites.

Refuting Liggett's story, Liggett's own planning analysis concluded that "Doral Introduction Accelerated Timing" of B&W's entry into black-and-whites, and that "Brown & Williamson Strategies" assumed that the "Category will Continue to Grow." DX 2009 at 90853-54. By the time of trial, moreover, generics accounted for one-third of all B&W cigarette sales, were deemed critical to B&W's future success, and were projected to account for up to one-half of B&W's future cigarette sales. Tr. 31:67; Tr. 71:146. In the third quarter of 1992 that projection proved correct. *Maxwell Consumer Report*, *supra*.

D. Proceedings Below.

Both lower courts held that Liggett failed to establish the requisite "reasonable possibility" of lessening competition because Liggett could not substantiate its novel "oligopoly recoupment" theory with record facts. Both courts also summarized the evidence which, contrary to Liggett, demonstrated more rather than less competition due to the entry of B&W and others into the generic segment previously dominated by Liggett.

The District Court Proceedings.

This case originated as a trademark infringement and unfair competition claim by Liggett which it lost before the jury and did not appeal. *Liggett Group Inc. v. Brown & Williamson Tobacco Corp.*, 1989-1 Trade Cas. (CCH) ¶ 68,583, at 62,098 (M.D.N.C. 1988); J.A. 30-33. The lawsuit was part of a strategy to "thwart" B&W's attempt to market black-and-white cigarettes. J.A. 184; DX 2038; Tr. 68:32-34.²³ Subsequently, Liggett added a

²³ Liggett gave wide publicity to its lawsuit and threatened customers with possible involvement in the suit, thereby exploiting customers' fears that they would be left with unsaleable and non-returnable inventory of B&W generics. This deterred many distributors from purchasing B&W's black-and-whites and caused others to cancel orders. DX 473; Tr. 68:32-33; DX 537; Tr. 68:32-33; Tr. 8:74; Tr. 69:179; Tr. 88:139; DX 444; Tr. 68:32-33; DX 491; Tr. 70:48-49; DX 493; Tr. 70:48-49; DX 2367; Tr. 70:13-14; DX

Robinson-Patman Act claim, dismissed on summary judgment and not appealed, which claimed illegal price discrimination between B&W's full-priced branded and its low-priced generic cigarettes. 1989-1 Trade Cas. (CCH) ¶ 68,583, at 61,099. Liggett further amended its Complaint, claiming that B&W's volume rebates in the sale of generics violated the Robinson-Patman Act. *Id.*

After a 115-day trial and 10 days of deliberation, the jury returned a verdict for Liggett. J.A. 27. As explained *supra* pp. 4-10, the instructions on competitive injury were fatally defective.

Almost six months thereafter, the district court entered j.n.o.v., now having a "complete record" enabling "the court to have a thorough understanding of the issues and facts in controversy" and of the "complex economic and legal issues." Pet.App. 18a n.4. The court's j.n.o.v. opinion rested on three separate grounds as to which, even as viewed most favorably, "Liggett's evidence falls short," *id.* at 24a: (1) lack of prospective competitive injury; (2) lack of causation, *i.e.*, Liggett's claimed injury rested on B&W's *low prices*, not on B&W's price differentials;²⁴ and (3) lack of antitrust injury to Liggett.

As to competitive injury (the sole issue on review here), the district court ruled that Liggett's proof was

2492; Tr. 70:48-49; Tr. 69:178; DX 788; Tr. 104:218; PX 29 ¶ 26; Tr. 11:141; DX 526; Tr. 68:32-33; DX 2091; Tr. 70:13-14; Tr. 8:84; Tr. 69:115-16; Tr. 69:162.

²⁴ The district court correctly held that "if there was any reasonable possibility of injury to competition from B&W's conduct it came from the low prices that B&W offered to its customers and not from the fact that these low prices varied depending on volume." Pet.App. 40a. Liggett argued that, even so, the price differences "facilitated" the low prices by making them cheaper for B&W than one low price. Pet.Br. 27. But as the district court understood, the price differences also made Liggett's resistance to the supposed predation cheaper, and by the same amount. As the district court recognized, moreover, the Act requires that competitive injury must be "the effect of" the unlawful discrimination, not of predation "facilitated" by such discrimination. Pet.App. 38a, 41a.

unsubstantiated and refuted by the record. The court noted that if "any of the other major cigarette manufacturers were interested in promoting the sale of generic cigarettes, even Burnett [Liggett's economic theory witness] admitted that successful predation by B&W would be impossible." *Id.* at 36a (emphasis added). The record established that "[e]ven before B & W began selling black and white cigarettes, RJR had entered the generic segment by repositioning Doral at generic prices." *Id.* Furthermore, there was "no evidence that any of the other major cigarette companies had an interest in slowing the growth of generic cigarettes." *Id.* The record demonstrated "steady growth" in the generic segment. *Id.* at 38a n.36.

The district court also stressed that Liggett's own economic expert's oligopoly recoupment theory "was contradicted by witnesses from the Liggett boardroom." *Id.* at 34a. The "unequivocal" trial testimony "from the senior executives at Liggett who made the pricing decisions" flatly contradicted its expert's forensic theory about "tacit collusion," "collusive oligopoly," and "excessive profits."²⁵ *Id.* at 34a-35a.

The Court of Appeals' Affirmance.

The unanimous Fourth Circuit panel affirmed because Liggett had failed to prove a prospective lessening of competition. The court distinguished this Court's decision in *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967), involving below-cost discriminatory geographic price cutting in one location by three multi-market competitors, aimed at injuring a small local seller, which they "subsidized" with their "economic muscle" from sales elsewhere. Pet.App. 8a. The court nowhere "ruled that the standard monopoly model is the only circumstance"

²⁵ The court emphasized that it had "allowed the case to go to trial" in view of affidavits stating that those executives were "confused" by B&W's lawyers, and "did not mean to contradict" Liggett's economic expert. At trial, however, "despite having consulted extensively with Burnett," the "Liggett executives again contradicted Burnett's theory." Pet.App. 35a.

supporting prospective recoupment, Pet.Br. 4, nor that "an oligopolist's unjustified, below-cost and discriminatory price never has a 'reasonable possibility of injuring competition,'" *id.* at 5.

Instead, the court focused on the facts that disproved competitive injury: the "actual experience" in the market—the "furious rebate war," the entry of RJR's Doral at black-and-white prices, the entry of all manufacturers into generics by the time of trial, the "dramatic" growth of generic sales from 2.8 billion sticks in 1981 to nearly 80 billion at time of trial, and the increase of generics' market share from 4% in 1984 to 15% at time of trial. Pet.App. 6a, 11a, 12a.

SUMMARY OF ARGUMENT

This case requires resolution of none of the questions Liggett presents for this Court's consideration. The disputes between the parties are entirely factual. B&W does not maintain, nor did the Court of Appeals for the Fourth Circuit hold, (1) that in a primary-line case the Robinson-Patman Act merely duplicates the Sherman Act by requiring a monopoly or a conspiracy, (2) that theory can override facts, or (3) that Robinson-Patman requires actual injury to competition rather than a reasonable possibility of such injury. Thus, there is no legal dispute for this Court to resolve.

Liggett would expand the reach of the Robinson-Patman Act through theories of oligopoly and predation that are unsupported by anything in case law or even in academic theorizing.

While some oligopoly theories, which B&W does not dispute, hold that firms may be able to achieve prices above the competitive level without collusion, no oligopoly theory holds that firms can, without communication, play the complicated game of oligopolistic predation that Liggett proposes. There are so many variables in the dynamic and unprecedented situation that confronted the industry after Liggett's success with black-and-white

cigarettes and RJR's repricing of Doral that it would be impossible for B&W to plan and carry out the campaign Liggett alleges. Thus, theory accords with the facts the district court and court of appeals rested upon.

Any firm contemplating a campaign of below-cost predatory pricing must, as Liggett admits, see a good prospect of recouping its losses with supracompetitive profits afterwards. That may occur when the would-be predator has reasonable hopes of achieving a monopoly, but not even Liggett supposes that B&W entertained any such wild dream. Instead, Liggett's theory is that B&W engaged in predation when it knew it would bear 100% of the losses and could, under the most favorable circumstances, enjoy only 12% of the uncertain future profits. No theory of predation supports that scenario and no one has ever shown predation of that impossible nature.

Liggett asks this Court to go far beyond *Utah Pie*, the leading case on primary-line injury to competition. Consistent with the expressed legislative concern over geographic price discrimination underlying this aspect of Robinson-Patman, *Utah Pie* held three multi-market firms liable for discriminatory price cutting in the single market of the victimized firm. Where all companies sell in the same market, it is inconsistent with the rationale of the primary-line application of Robinson-Patman and of *Utah Pie* to allow one small competitor to recover from another small competitor for lowering prices in one segment of the larger market. Should that become the law, every national marketer would be subject to treble damages for cutting prices anywhere.

The danger to hard competition is not averted by Liggett's argument that the cigarette market is "concentrated." Fully half of the manufacturing, distributing, retailing, and service industries in this country—national, regional, and local—are concentrated. If concentration is enough to put a 12% firm in danger for price cutting, price competition will be extremely hazardous in many industries and markets.

The Robinson-Patman Act goes beyond the Sherman Act, but this Court has recognized the need to accommodate the later statute to the basic antitrust policies of the earlier, wherever possible, in order to preserve competition. To hold B&W liable on the facts here would send a signal to many industries, including the smaller firms in those industries, that tough price competition brings treble damage retaliation.

To avoid an affirmance because competition intensified in the cigarette market, Liggett misstates what the Fourth Circuit held and offers a new, anticompetitive rule of its own.

Both courts below expressly employed a "possible injury" standard and stressed the facts that showed not only that there was no possible injury but that competition had in fact intensified after RJR and B&W entered the generic segment of the market to compete with Liggett.

Courts regularly hold that the fact of increased competition overwhelms any fleeting theoretical suspicion of a possible lessening of competition. No sensible jurisprudence could hold otherwise. Liggett's proposal to "educate[] would-be predators" by imposing treble damage liability even where competition increases merely means that theoretical conjecturings about what might have happened will trump the facts of what did happen. That is a prescription for the suppression of competition. The vigorous competitor, now renamed the "would-be predator," will in truth be educated that it is dangerous to compete.

ARGUMENT

Introduction

Liggett's case seeks to crossbreed the Sherman Act with the Robinson-Patman Act to produce a hybrid anti-trust law. The object of that exercise is to win a judgment that Liggett cannot obtain under either of the statutes as written. A suit laid under § 2 of the Sherman Act for attempted monopolization by predatory pricing would be laughed out of court because here the alleged "predator" has only 12% of the market. A suit for price discrimination fails because B&W's volume rebates caused Liggett no injury. Liggett complains that B&W's prices were below its own at every volume. Thus, Liggett's objection is to low prices (a Sherman Act claim), not to different prices. There are very good reasons why Liggett should not be allowed to succeed with this statutory legerdemain.

I. THE DECISION OF THE COURT OF APPEALS WAS CORRECT.

A. Liggett's "Questions Presented" Are Not Presented By The Facts Of This Case.

The sole issue before this Court is entirely fact-bound. Although Liggett denied this in petitioning for certiorari, its brief is almost entirely factual argument. There is no alternative but for this Court to decide on the record whether the district court and the court of appeals correctly assessed the facts or whether Liggett has done so.

For that reason, this case does not require resolution of any of Liggett's "Questions Presented." These are purely hypothetical questions, not presented by the facts and not decided by either of the courts below. B&W is prepared to answer each of Liggett's questions as Liggett wants:

1. B&W agrees that the Robinson-Patman Act retains "independent force" and does not "address only a monopoly or conspiracy already covered by the Sherman Act." The Fourth Circuit never said otherwise; it merely found

Liggett's Rube Goldberg version of oligopoly theory doubtful and contradicted by the facts. *Utah Pie* remains precedent, even with the modifications that Liggett suggests to this Court. Pet.Br. 37, 39-41. Thus, the Robinson-Patman Act retains independent force. The companies found to have violated the Act in *Utah Pie* were neither monopolists nor conspirators.

2. B&W agrees that a court's "theoretical speculation" may not "vitiate a jury verdict based on the calculations, conduct, and success of the actual respondent." That proposition is established by *Eastman Kodak Co. v. Image Technical Services, Inc.*, — U.S. —, 112 S. Ct. 2072, 2082, 2085 (1992), a case that Liggett circulated to all the judges on the Fourth Circuit Court of Appeals without eliciting a single vote for rehearing *en banc*.

The question Liggett proposes for debate in this Court is not presented by this case for two reasons. First, the court of appeals found, as did the district court, that it was Liggett's "theoretical speculation" that was not borne out by the facts. Second, as B&W has shown, *supra* pp. 4-10, the jury's general verdict, especially given the court's instructions, is perfectly opaque. It cannot be said that the jury found anything more than aggressive remarks in B&W's pre-Doral documents and related those remarks to a non-existent generic submarket.

3. B&W agrees that the Act requires a reasonable threat of injury to competition and consumers rather than actual damage. But that question has no relevance to a case where the evidence clearly shows an intensification of competition to the benefit of consumers.

B&W has shown that the court of appeals and the district court were correct in their view of the facts. B&W will next demonstrate that Liggett's case is also fatally defective both theoretically and legally.

B. The District Court And The Court Of Appeals Were Correct In Remarking That Liggett's Novel Oligopoly Theory Is "Dubious" And "Suspicio[us]."

Liggett urges upon this Court an economic theory of oligopoly behavior that not only has never been accepted by any court but that has not been espoused in even the most speculative academic literature. Liggett asks this Court to announce as law an abstract economic theory that is not merely *avant garde* but bizarre.

Some oligopoly theories (there are many) hold that manufacturers may develop the habit of going along with each other's price increases because each understands that is the most profitable course. Such tacit collusion, where it exists, requires a single variable, usually price, as well as long experience so that reactions to that variable are predictable. Liggett continually cites such standard theories to support its case here, but this case requires Liggett to advance a much more complicated theory, one that has no support in the literature or the case law. It is not enough for Liggett to point to uniform list price increases on branded cigarettes (which, as shown, *supra* p. 27, are meaningless because they are not the actual transaction prices). Liggett must advance a tenable theory about B&W's ability to engage in predatory pricing of generic cigarettes with assurance that no other cigarette seller will enter, expand, or maintain low prices in the generic segment. But here Liggett runs into theoretical difficulties, as well as the factual difficulties already described.

No oligopoly theory supposes that manufacturers, without communicating, can fly in tight formation when the situation they face is wholly unprecedented,²⁶ there is no

²⁶ As Liggett told its customers, the summer of 1984 was "a period of unprecedented competitive entry programs. . . ." DX 540; Tr. 68:32-33. Liggett's "history of anticompetitive conduct," Pet.Br. 6 & n.10, omits that the long-time "Big Three" of the pre-war industry—the defendants in the government antitrust prosecution—were RJR, American, and Liggett, but not B&W. F.M. Scherer &

guidance from past practice, there are many variables, and it is entirely unclear which course of action is the most profitable.²⁷

Predicting the actions and reactions of oligopolistic rivals is the subject of game theory, and it is quite clear that game theory refutes Liggett's suppositions. Professor Robert Dorfman, analyzing the strategies of duopolists attempting to advance their own positions "without igniting an uncontrollable sequence of challenges and retaliations," demonstrated that "any constant sum game with two players is solvable—i.e., has readily discoverable best choices for both players. More complicated games rarely are." Robert Dorfman, *The Price System* 99-100 & n.10 (1964).²⁸

The game Liggett supposes is extremely complicated. There were not two players but six. Of the five that were contemplating their individual responses to Liggett's generic sales, each had a number of possible responses—stay out of the generic segment, introduce black-and-whites, introduce branded generics, introduce private labels, introduce "Value-25s," or some combination of these tactics. Moreover, as to each type of product, there was a wide range of marketing strategies available—cutting prices across the board, volume discounts, stickering, couponing, free products with each purchase, and,

David Ross, *Industrial Market Structure and Economic Performance* 250-51 (3d ed. 1990) ("Scherer & Ross").

²⁷ See *Antitrust Law* ¶ 404b2, at 276 (1978) (even "effective price coordination among oligopolist . . . will not be possible when any significant firm chooses, for any reason, to 'go it alone.'"); *id.*, ¶ 404b3, at 277 (oligopoly stability "will quickly evaporate if rivals misread a price change or make disparate responses, as they are likely to do").

²⁸ See also Scherer & Ross at 279 ("when products are heterogeneously differentiated, the terms of rivalry become multidimensional, and the coordination problem grows in complexity by leaps and bounds").

where the generic is branded, advertising.²⁹ And each of these tactics could be applied to branded cigarettes, generics, or both.

B&W itself recognized this in a March 22, 1984 planning document that was pre-Doral: "Innovation can come on many fronts—product, packaging, pricing, marketing, etc."³⁰ J.A. 100. In short, the game Liggett proposes was not "solvable" by the cigarette companies. There was not even a theoretical possibility that B&W could plan a predatory campaign on the basis of confidence about the reactions of others. Thus, there was very good reason for the district court to note that "[t]acit collusion among the major cigarette manufacturers is a dubious theory of market power," Pet.App. 33a, and to buttress its own doubts with the doubts of Liggett's counsel:

²⁹ Liggett itself had not only volume rebates but multiple programs involving secret rebates, special promotional payments, and other sales inducements that had significant effects on net prices. Holman Brown, the witness Liggett designated under Rule 30(b)(6) as knowledgeable concerning Liggett's sales activities, said that to find the net price to a customer would be like "a blind man feeling his way around the office and find out who does what." Tr. 104:24, 56.

³⁰ Thus, the competitive actualities at the time of Doral's and B&W's entry into generics in 1984 included: (1) more than 200 cigarette varieties (filter and non-filter), (2) marketed by six manufacturers, (3) through different distribution channels (*i.e.*, wholesalers, national chains, etc.), (4) under various designations (branded, generic, private label), (5) at multiple price points (list prices for branded, black-and-white generics, branded generics, private label), and (6) offset by an array of rebates, discounts, promotional deals, shelf payments, stickering, coupons, allowances, etc. These conditions defy any conceivable oligopolistic coordination of the complexity Liggett imagines.

Such diversity "magnifies the complexity of the interactions manyfold." *Scherer & Ross* at 214. Thus, *Scherer & Ross* concludes that the cigarette industry in recent years "has failed to achieve a high degree of market-sharing coordination." *Id.* at 251 n.50. See also Daniel Sullivan, *Testing Hypotheses About Firm Behavior in the Cigarette Industry*, 93 J. Pol. Econ. 586, 587 (1985) (results "point to at least a moderately high level of competition").

[A] leading antitrust authority has noted that the scenario for predatory pricing by a firm possessing a small share of the market is "highly speculative" and "presses the potential for tacit price coordination very far." P. Areeda & H. Hovenkamp, *Antitrust Law* 711.2c, at 538-39 (Supp. 1989).

Id. at 34a.

Liggett's "oligopoly recoupment" theory further supposes that one firm can "discipline" price-cutters without unravelling tacit arrangements that support monopolistic prices. Oligopoly cohesion presupposes similar attitudes and reactions among all oligopolists; but Liggett's theory is that B&W chose to go it alone as the industry "hit-man." If Liggett is permitted to assume a divergent strategy by B&W, why must B&W be assumed to predict *uniform* reactions by all four other firms?

The lone-wolf "disciplinary" plan attributed to B&W by Liggett is irrational without communication and agreement. Even the far-fetched theories of tacit collusion described in economics literature do not allow for *divergent* responses to an oligopoly "defector."³¹ Disciplinary measures recognized in contemporary theory always involve participation by *every* rival. See, *e.g.*, C. Shapiro, *Theories of Oligopoly*, in *Handbook of Industrial Organization* 329, 363ff., 370ff. (R. Schmalensee & R. Willig eds., 1989). Not even Liggett alleges that this was the case here.

Though Liggett's economic theory is impossible and contradicted by its own economic expert, neither the district court nor the court of appeals decided the propriety

³¹ The closest approach is the 1989 Supplement to *Antitrust Law*, but even that work states that oligopolistic predation cannot succeed unless companies which in the aggregate dominate the market attack in unison. *Antitrust Law* ¶ 711.2c, at 538-39 (Supp. 1989). But see *Antitrust Law* ¶ 711.2c, at 647 (Supp. 1992). Liggett has never alleged that even one of the other four cigarette companies, which collectively have 85% of the market, has engaged in predation.

of j.n.o.v. on these grounds. To the contrary, the district court went out of its way to emphasize that in rejecting the theory on the facts here, the court did "not rule that this theory is insufficient as a matter of law." Pet.App. 34a. And the court of appeals rested throughout on the record evidence and said that its "suspicions" were confirmed by the facts. *Id.* at 12a-13a. Both courts were right about Liggett's dubious and suspicious economic theorizing, but both backed up their doubts with facts.

C. Liggett's Theory Of Predation Is Impossible.

As this Court recognized in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), even in cases of "predatory pricing by a single firm seeking monopoly power," *id.* at 590, "the success of [predatory pricing schemes] is inherently uncertain; the short-run loss is definite, but the long-run gain depends on successfully neutralizing the competition. . . ." *Id.* at 589. Liggett itself recognizes that the "predator's calculus" is far more speculative for a single oligopolist than even for a "single firm" predator:

[I]f predation is successful, the monopolist alone reaps its fruits, while an oligopolist must share the fruits with surviving oligopolists, and the smaller oligopolist may benefit less . . . than the larger ones.

Pet.Br. 28. Indeed, "[t]he uncertain future gains must greatly exceed the present actual losses to overcome the uncertainty that rivals will be destroyed or disciplined and that monopoly profits can be reaped in the face of future entry." Areeda, *Monopolization, Mergers and Markets*, 75 Cal. L. Rev. at 965 (emphasis added).

Particularly apt here is the conclusion that "[i]f rivals survive or entry occurs, not only will predation be unsuccessful, but that very prospect reduces the likelihood that a challenged low price is in fact predatory. Whenever the market circumstances make such predation unlikely, it is probably absent." *Id.* Here B&W had less than 12% of the market. By Liggett's own admission, therefore, B&W would have received less than 12¢ for every dollar

"recouped" by the industry—including Liggett. Moreover, as Liggett again recognizes:

[A] predator anticipating entry-resistant monopoly hopes that it alone will set the post-predation price, while an oligopolist such as B&W knows that future prices depend upon the choices of fellow oligopolists.

Pet.Br. 29 (emphasis added).

Thus, B&W not only reaps a tiny fraction of the "recoupment" it allegedly generates, but also must count on continued oligopoly stability, lest the source of recoupment vanish in a flurry of competitive moves and counter-moves. In short, Liggett's "oligopoly predation" theory presupposes a calculation by B&W that would have gone well beyond the speculative into the realm of the irrational.

II. BOTH ANTITRUST LAW AND POLICY SUPPORT THE JUDGMENTS BELOW.

Liggett's case is defective in law because it goes far beyond any decided case and urges this Court to adopt a rule of law that would effectively stifle price competition in many, if not most, markets.

A. The Robinson-Patman Act Does Not Impose Liability On B&W.

The Fourth Circuit recognized that the Robinson-Patman Act's proscription of predatory price discrimination extends beyond cases involving monopolies and conspiracies, which are already covered by the Sherman Act. The court held only that Robinson-Patman does not punish B&W's competition.

There is no doubt, for example, that the court recognized that *Utah Pie* remains a precedent. There similarly can be no quibble that *Utah Pie* demonstrates that the Robinson-Patman Act reaches cases that the Sherman Act does not reach. It is palpably untrue, therefore, that the Fourth Circuit made the Robinson-Patman Act redundant in primary-line cases. The relevant question is what *Utah Pie*, in particular, and antitrust law and policy, more generally, require in the present case.

Liggett asks this Court to go far beyond *Utah Pie*. That case involved, as this case does not, geographic price discrimination. Geographic price discrimination was the concern of the 1914 Clayton Act provision, retained in the 1936 Robinson-Patman amendments, invoked by Liggett:

In the past it has been a most common practice of great and powerful combinations . . . to lower prices of their commodities, oftentimes below the cost of production . . . with the intent to destroy and make unprofitable the business of their competitors, and with the ultimate purpose in view of thereby *acquiring a monopoly in the particular locality* or section in which the discriminating price is made. Every concern that engages in this evil practice must of necessity *recoup* its losses . . . by raising the price of this same class of commodities above their fair market value in other sections or communities. . . . [T]he present antitrust laws ought to be supplemented by making *this particular form* of discrimination a specific offense under the law. . . .

H.R. Rep. No. 627, 63d Cong., 2d Sess., pt. 1, at 8-9 (1914) (emphasis added); *Goodyear Tire & Rubber Co. v. Federal Trade Commission*, 101 F.2d 620, 623 (6th Cir.), cert. denied, 308 U.S. 557 (1939).

It may be a proper extension of that concern, and of *Utah Pie*, to apply the Act to non-geographic cases where the predator operates in many product markets and the victim in but one. The rationale is the same. The predator can afford its losses in the victim's market because of profits made in other markets. That rationale has no application here. The parties stipulated, and the district court agreed, that Liggett and B&W sell in the same market.

So long as the rationale of *Utah Pie* is adhered to, § 2(a) guards against predation while posing little threat to vigorous price competition. But Liggett seeks a vast expansion of *Utah Pie* by applying it to price competition in one corner of a single market. It is as though one

national seller of pies sued another national seller for reducing prices in Salt Lake City. If such a suit were successful—and that is Liggett's suit—every national marketer would be afraid to cut prices anywhere.³²

B. Holding B&W Liable For Vigorous Competition Would Seriously Impair Legitimate Price Competition In Many Markets.

The danger to hard competition is not averted by Liggett's insistence that the cigarette market is "concentrated."³³ Liggett has not faced up to what that contention means. Fully half of the markets in this country can be classified as concentrated. Tr. 100:201. If price cutting in part of a single "concentrated" product or geographic market is sufficient to support an inference that a firm with as little as 12% of the general market is a predator, price competition will become extremely hazardous throughout most of American industry and

³² Liggett attempts to avoid this point by arguing that it was weak in branded cigarettes, so presumably its branded sales can be disregarded and it can be viewed as a single-market victim just as was the plaintiff in *Utah Pie*. That argument, if accepted, would thrust courts into making judgments about how well or poorly a firm has to be doing in the market segments where price cutting is not taking place in order for *Utah Pie's* rationale to apply. Quite aside from the legal quagmire Liggett thus urges this Court to enter, the argument has no place here because Liggett itself announced in 1989 that its branded cigarettes were its "lifeblood," J.A. 315, and Liggett was profitable throughout the period of alleged predation. Pet.App. 48a.

³³ The radical novelty of Liggett's new theory of the Robinson-Patman Act is not mitigated by references to Clayton Act § 7 anti-merger enforcement. Pet.Br. 5, 29, 30 & n.35. Unlike the primary-line anti-price discrimination provisions that aim at geographic price cutting by large national firms injuring small local rivals, Clayton Act § 7 sought to stem a "rising tide of economic concentration." *E.g., United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 362-63 (1963). Hence Liggett gains no legal leverage from anti-merger law enforcement to distort Robinson-Patman into an anti-oligopoly measure—a conversion unsupported by the Act's uniquely detailed text or by its legislative purpose, and unprecedented in over half a century of the Act's application.

commerce. For this reason, antitrust courts have been very careful about permitting inferences of predatory pricing. *E.g.*, *Spectrum Sports, Inc. v. McQuillan*, No. 91-10, slip op. at 11 (U.S. Jan. 25, 1993).

This Court has frequently recognized, and Liggett concedes, the need to interpret the Robinson-Patman Act so as to accommodate the policies of the Sherman Act, whenever that is possible. To protect one producer from competitive entry and aggressive pricing by another, as here, would squarely set Robinson-Patman against "the broader antitrust policies" laid down by Congress. *E.g.*, *United States v. United States Gypsum Co.*, 438 U.S. 422, 458 (1978); *Automatic Canteen Co. v. Federal Trade Commission*, 346 U.S. 61, 74 (1953). Liggett has not come close to proving recoupment, the test that both sides agree distinguishes predatory pricing from vigorous competition.

III. DRAMATICALLY INCREASED COMPETITION DUE TO B&W'S ENTRY INTO THE SALE OF GENERICS CONSTITUTES AN INDEPENDENT GROUND FOR AFFIRMING THE JUDGMENT BELOW.

The dramatically increased competition sparked by RJR's and B&W's entries into the generic segment independently supports affirmance by this Court.

To avert such an affirmance, Liggett invents a Fourth Circuit "alternative holding that the absence of consummated injury" exonerates B&W of its "otherwise predatory conduct." Pet.Br. 44. But Liggett (1) misstates the lower court's holding as having erroneously required *actual* injury rather than the statutory possible injury to competition, and (2) wrongly maintains that even the *actuality* of more competition cannot rebut the *prospective* lessening of competition inferable from B&W's conduct—which must "be judged as of the time it occurs" because this "educates would-be predators as to their duties under the statute." *Id.* at 45.

A. The Holdings Below Expressly Turned On "Possible Injury," Not "Consummated Injury," To Competition.

Both courts below expressly applied the statutory "possible injury" standard, and the Fourth Circuit's decision nowhere suggests, let alone imposes, any "requirement of actual effects." *Id.* at 23. But no inference of a possible injury to competition can withstand the fact that competition actually intensified. To allow such a preposterous result would not only chill competition in the future but would be directly contrary to this Court's recent *Eastman Kodak* decision which stressed the priority of "actual events" over "economic theories." In measuring the competitive impact of business practices in order "to resolve antitrust claims on a case-by-case basis," courts must focus on actual record facts. *Eastman Kodak*, 112 S. Ct. at 2082.³⁴

Rather than requiring "actual injury" to competition, both courts below summarized the uncontroverted evidence demonstrating more rather than less competition due to B&W's and others' entries into the sale of generics, a category which Liggett had dominated for several years. In particular, the Fourth Circuit opinion stressed:

—Liggett's 97% domination of generic sales prior to RJR's "repositioning" of Doral and B&W's entry into generics in mid-1984, Pet.App. 6a;

³⁴ Although addressed by Liggett, Pet.Br. 46 n.58, the issue of "antitrust injury," which was an independent legal basis for the district court's j.n.o.v. that was not reached by the Fourth Circuit, is *not* before this Court. In any event, Liggett's latest focus on "managing prices upward" and "higher prices" creating "actual injury to competition and consumers," Pet.Br. 44, vitiates any "antitrust injury" to Liggett. Liggett plainly lacks standing to challenge *higher* cigarette prices, which might theoretically inflict "antitrust injury" on consumers but *not* on a competitor who benefits from higher prices that *help* not *hurt* its own competitive opportunities. *E.g.*, *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990); *Cargill, Inc. v. Monfort, Inc.*, 479 U.S. 104, 116 (1986); *Matsushita*, 475 U.S. at 583; *Clamp-All Corp. v. Cast Iron Soil Pipe Inst.*, 851 F.2d 478, 485 (1st Cir. 1988), *cert. denied*, 488 U.S. 1007 (1989).

- B&W's third-ranking 12% market share, dwarfed by PM (41.9%) and RJR (28.5%), *id.* at 3a;
- the "furious rebate war," and explosion of diverse discount deals erupting after B&W's entry, *id.* at 5a-6a, 12a-13a;
- the confirmation by Liggett's own executives that the companies fought "tooth and nail," that the market "got very competitive," and that "competition had substantially increased in the total cigarette market," *id.* at 6a;
- the ensuing dramatic growth of the economy segment as all other cigarette manufacturers successively entered the fray with a variety of economy cigarettes including branded generics and black-and-whites, *id.* at 6a, 12a-13a;
- the intensified competition due to the several companies' "vigorously competing with differing devices and approaches," *id.* at 12a;
- the consequent expansion of economy cigarettes from 2.8 billion in 1981 to nearly 80 billion in 1989, mushrooming from .4% to 15% of the U.S. cigarette market as of 1990, *id.* at 12a-13a; and
- Liggett's tripling of its generic sales from 2.8 to 9 billion between 1981 and 1988, *id.* at 6a.

In sum, having nowhere required "proof of actual injury," the decisions below marshalled the uncontroverted record evidence, confirmed by Liggett's own executives, that competition dramatically increased due to B&W's entry into generics.³⁵

³⁵ Liggett recognizes that acceptance of its theory would have a tremendous potential "chilling" effect on price competition, but proposes that the Court adopt "filters" to protect the unwary, and claims that this case has passed through each of its six filters. Pet.Br. 41-42. This is untrue. For example, the first filter was not satisfied because the trial court's instructions erroneously denied B&W its valid meeting competition defense. Moreover, the facts stated by both courts below and in this brief, *supra* pp. 10-31, demonstrate that this case has not passed through a single one of the other "filters."

B. Many Robinson-Patman Act Decisions Hold That Proof Of More Actual Competition Rebutts Any Inference Of Prospective Lessening Of Competition Due To Challenged Price Discrimination.

Contrary to Liggett's assertions that the competitive impact of challenged pricing must "be judged as of the time it occurs," which "educates would-be predators" as to their legal duties, Pet.Br. 45, price discrimination claims routinely fail whenever the actuality of *more* competition negates the prospect of *lessened* competition inferable from the challenged price discrimination. *E.g.*, *Boise Cascade Corp. v. Federal Trade Commission*, 837 F.2d 1127, 1144 (D.C. Cir. 1988) (inference of competitive injury can be "overcome by evidence showing an absence of competitive injury").³⁶ Nothing supports Liggett's speculative assertion of primary-line competitive injury because "the generic segment would have been even larger in the absence of B&W's predatory conduct." Pet. Br. 44; *e.g.*, *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340, 347 (3d Cir. 1981), *cert. denied*, 455 U.S. 1017 (1982) (competitive injury cannot be based on "speculative possibility" of even more competition in the absence of price discrimination).

Furthermore, an assessment of the competitive actualities in the wake of B&W's alleged predatory pricing, which both lower courts undertook, was imperative here because of the highly speculative (at best) character of Liggett's oligopolistic recoupment theory. In sum, nothing supports Liggett's doctrine that ordains oligopoly theorizing about possible future reactions of rivals, but

³⁶ Many Robinson-Patman primary-line cases are in accord: *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340, 347 (3d Cir. 1981), *cert. denied*, 455 U.S. 1017 (1982); *Dean Milk Co. v. Federal Trade Commission*, 395 F.2d 696, 714 (7th Cir. 1968); *Anheuser-Busch, Inc. v. Federal Trade Commission*, 289 F.2d 835, 842 (7th Cir. 1961); *Minneapolis-Honeywell Regulator Co. v. Federal Trade Commission*, 191 F.2d 786, 790 (7th Cir. 1951) (volume discounts), *cert. dismissed*, 344 U.S. 206 (1952).

forbids looking at what actually happened in the marketplace.

C. Liggett's Theories Would Set The Robinson-Patman Act At Odds With "Broader Antitrust Policies Laid Down By Congress," Chill Price Competition, And Foment Treble Damage Litigation.

Liggett's freeze-frame interpretation of the statutory competitive injury requirement gravely magnifies the Robinson-Patman risks and treble damage exposures of business firms' daily pricing decisions. Primary-line injury claims would preclude defendants from showing the actual impact of their alleged discriminatory pricing "predation," and how they in fact, as here, intensified competition in the marketplace. Hence, Liggett's modest proposal for judging competitive injury in the dark "educates would-be predators," Pet.Br. 45, with a vengeance. Not the least, Liggett's draconian teaching tools bode large burdens on courts and business firms alike, to the detriment of U.S. firms' competitiveness and ultimately the American consumer.

Particularly in primary-line price discrimination cases, which are uniquely prone to abusive litigation to thwart hard price competition by business rivals, the Robinson-Patman Act should not be strained beyond its text and province.³⁷ Instead, the Act should be construed to avert a chilling effect on competitive pricing, "the central ner-

³⁷ "When a business rival brings suit, it is often safe to infer that the [challenged] arrangement is beneficial to consumers." Frank Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 18 (1984).

Business rivals have an interest in higher prices, while consumers seek lower prices. Business rivals seek to raise the costs of production. . . . The books are full of suits by rivals for the purpose, or with the effect, of reducing competition and increasing price. . . . [The Department of Justice and the courts] should treat suits by horizontal competitors with the utmost suspicion.

Id. at 34-35.

vous system of the economy." *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224 n.59 (1940). Realistic rather than expansive Robinson-Patman interpretations would treat price cutting as a *preferred* form of business behavior in free markets, akin to the free expression protected by the First Amendment. *E.g.*, *Spectrum Sports*, slip op. at 11; *Eastman Kodak*, 112 S. Ct. at 2088; *Atlantic Richfield*, 495 U.S. at 338; *Matsushita*, 475 U.S. at 594.

Not least, penalizing B&W's generic entry and competitive price cutting would twist antitrust policy into a confrontation with itself. At the core of this case is a vigorous competitive encounter between two profitable rivals, each backed by the "staying power" of a large parent, which met head-to-head in competition for the new and growing generics segment for cigarettes in which Liggett held 97% of the business prior to B&W's entry. The inevitable competitive responses by other firms set off a fierce "rebate war" and mushroomed the economy segment, bringing huge consumer savings.

Above all, as recently stressed by a unanimous Court, lest antitrust interpretations "chill competition, rather than foster it," the Sherman Act "directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself. It does so not out of solicitude for private concerns but out of concern for the public interest." *Spectrum Sports*, slip op. at 11. For the same reason, the Robinson-Patman Act must be read to foster competition, not to suppress it.

CONCLUSION

The decision of the Fourth Circuit should be
AFFIRMED.

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No. 92-466

In The
Supreme Court of the United States
October Term, 1992

LIGGETT GROUP INC., now named Brooke Group Ltd.,
Petitioner,
vs.

BROWN & WILLIAMSON TOBACCO CORPORATION,
Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fourth Circuit

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

The issue before the Court is whether the Fourth Circuit correctly decided that predatory pricing is such an implausible strategy for an oligopolist that a jury verdict under the Robinson-Patman Act must be set aside. The jury necessarily found that respondent B&W had engaged in below-cost price discrimination with a reasonable prospect of recoupment -- that is, predation. *See infra* p. 9. The Fourth Circuit affirmed judgment notwithstanding the verdict on the ground that only a monopolist or conspirator can be sufficiently certain of recoupment to engage in predatory price discrimination. It did not adopt B&W's version of the facts.¹

1. *The Fourth Circuit Ruled Out Oligopolistic Predation as a Matter of Law.* Far from being "fact-bound," the opinion below proclaims its generally applicable "economic logic." The court recognized that the verdict "amounts to substituting the conscious parallelism of an oligopoly for conspiratorial agreement or actual monopoly power as the reason Brown & Williamson might rationally expect to be able to recoup its investment in disciplining Liggett." Pet.

*Reference is made to Pet. Br. 2 at n.2 for Liggett's statement pursuant to Supreme Court Rule 29.1.

¹In particular, the Fourth Circuit did not deny that a reasonable jury could find that B&W itself concluded that it could recoup an investment in below-cost pricing, that B&W actually priced generic cigarettes below their average variable cost under a plan to injure *consumers* as well as Liggett, that regular-brand prices were supracompetitive, and that cigarette prices rose more than costs or inflation. *See infra* pp. 11-19 (setting the record straight in response to the extravagant factual claims of B&W's brief). As for the district court, it concluded that B&W's plan was anticompetitive and designed to "slow the growth of the generic cigarette segment." Pet. App. at 31a. The district court made clear, moreover, that apart from its view of the law, it regarded the verdict as fully supported. *Id.* at 19a n.6. In any event, the facts must be viewed in the light most supportive of the verdict. *See infra* p. 11.

App. at 11a. The court then proclaimed that oligopolists cannot be "certain" (*id.* at 11a) or "assured" (*id.* at 14a) of one another's reactions, and ruled: "To rely on the characteristics of an oligopoly to assure recoupment of losses from a predatory pricing scheme after one oligopolist has made a competitive move is thus economically irrational." *Id.* at 13a. To be sure, the Fourth Circuit mentioned the "actual experience in this case," but only to use growth in the generic sector to buttress -- erroneously (*see infra* pp. 6-7) -- its "theoretical suspicions." Pet. App. at 12a.

B&W itself underscores the theoretical rather than factual basis of the Fourth Circuit opinion by defending it with arguments that immunize every oligopolist on theoretical grounds no matter how far below average variable cost its price discrimination, how high the profits it seeks to protect, or how explicit its anti-consumer strategy.² Indeed, the only *fact* cited by B&W to show the "impossibility" of Liggett's claim is B&W's 12% market share (Resp. Br. at 40), which is only another way of saying that B&W is not a single-firm monopolist capturing the entire benefits of predation as its recoupment. But recoupment does not require that a predator obtain all the benefits of predation, only enough of them to exceed substantially its investment in predation. *See* Pet. Br. at 28-29. B&W calculated that it alone could lose \$350 million if generics continued to grow at the same rate. To recoup its investment of \$15 million in below average variable cost pricing, B&W would have to slow the growth rate by only a small amount -- which its sophisticated managers decided they could achieve. If prospective recoupment is ruled insufficiently plausible here, no

²B&W was more explicit below, asking the Fourth Circuit to rule out oligopolistic predation as a matter of law on the ground that "[r]ecoupment requires the acquisition and sustained exercise of monopoly power" and that monopoly power requires a "single firm" with at least a "dominant share" of the market. B&W's Fourth Circuit brief at 21, 24-25. Amici supporting B&W are equally explicit, asking this Court to adopt the Sherman Act standard and require a dangerous probability of single-firm monopoly before allowing any violation of the Robinson-Patman Act to be found.

oligopolist can ever be liable for unjustified below-cost price discrimination.

B&W's theoretical arguments, relying largely on "game theory," also rest on the false premise that coordinating oligopolists need to coordinate everything in order to achieve or maintain supracompetitive prices. B&W insists that tacit price coordination in an oligopoly "requires a single variable, usually price." That is quite wrong, for tacit price coordination can, and often does, exist side by side with non-price rivalry in such multiple variables as advertising and product variations.³

B&W insists that it "was not even a theoretical possibility that B&W could plan a predatory campaign on the basis of confidence about the reactions of others" because (1) a predating oligopolist must have "assurance that no other cigarette seller will enter, expand, or maintain low prices in the generic segment," and (2) such assurance is impossible "without communication" when the situation is new, variables are numerous, and when views differ on whether it will be profitable to enter generics and in what form. Resp. Br. at 36-38. But this ignores B&W's own express calculation that fellow oligopolists (a) were likely to enter the generic segment with variations in packaging, promotions, and marketing, (b) had the strongest possible incentive to narrow the discount as far as possible in order to minimize cannibalization of their mainstay regular brands, (c) would move branded-generic prices up quite readily after such brands won consumer loyalty, and (d) would continue to price branded cigarettes in the textbook oligopoly fashion of preceding decades -- even without any overt communication.

³Indeed, this point is made by the very authority B&W cites for the proposition that numerous variables complicate oligopolistic coordination and that the cigarette manufacturers have recently "failed to achieve a high degree of market-sharing coordination." Resp. Br. at 38 n.30. The precise point of Scherer & Ross, *Industrial Market Structure and Economic Performance* 251 (3d ed. 1990), is that non-price rivalry can affect market shares without preventing oligopolistic price leadership and an increase in profits "from \$3.80 to \$11.55 per thousand cigarettes sold between 1980 and 1988."

See Pet. Br. at 17-18. Indeed, B&W studied past episodes of disciplining price cutters before embarking on its below-cost price discrimination. PX 40, Tr. 60:62, J.A. 128. Not only was it "a theoretical possibility that B&W could plan a predatory campaign," it did so.

B&W theorizes that one firm cannot discipline a maverick "without unraveling . . . [o]ligopoly cohesion," asking "[i]f Liggett is permitted to assume a divergent strategy by B&W, why must B&W be assumed to predict *uniform* reactions by all four other firms," and asserting that "[d]isciplinary measures recognized in contemporary theory always involve participation by *every* rival." Resp. Br. at 39 (original emphasis). Again, the facts are otherwise. B&W itself explained that it would discipline Liggett unilaterally because its larger rivals, though they would welcome a narrower gap, (1) would not discipline Liggett because of the greater risk of being held accountable for violating the antitrust laws and (2) would not need to do so once B&W acted. See Pet. Br. at 17. B&W could discipline Liggett without the participation of the larger oligopolists because only B&W and Liggett were selling black-and-white cigarettes at the time. Significantly, Doral did not participate in the rebate war. Pet. Br. at 8 n. 12.

In disowning the oligopoly recoupment strategy carefully worked out and analyzed by B&W's sophisticated senior officers, B&W's brief, like the Fourth Circuit, draws absolute rules from an economic theory that is only suggestive in the first place, theorizing about markets in the abstract rather than attending to the facts of this case. Short of establishing genuine impossibility, B&W's arguments about the complexities and uncertainties of recoupment in oligopoly cannot immunize unjustified below-average-variable-cost pricing designed to injure consumers, for the law requires only a "reasonable possibility." Apart from its theoretical arguments, B&W offers no valid reasons why the jury verdict should not stand. See *infra* pp. 9-19.

2. *The Robinson-Patman Act Reaches this Case.* B&W argues that the Robinson-Patman Act covers, at most, only geographic discrimination and perhaps "non-geographic cases where the predator operates in many product markets and the victim in but one."⁴ Resp. Br. at 42. B&W's rationale for its limitation is that a multi-product predator can outlast the one-product victim, but that outlasting rationale condemns B&W's below-cost discrimination based on its own explicit analysis that Liggett was dependent upon black and whites rather than regular brands (J.A. 73), would be "unlikely . . . to engage in a sustained battle" (J.A. 97), and "will try to survive" the losses inflicted by B&W by "raising [list] prices on generics." J.A. 253. See also J.A. 260, 263.

Although B&W insists that "Liggett's case . . . goes far beyond any decided [Robinson-Patman Act] case" (Resp. Br. at 41), its conduct was clearly less justifiable than that held unlawful by the Court in *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967), and the threat to competition here was clearly greater than in that case.⁵ Far from asking this

⁴In B&W's non-geographic illustration, competition is injured because the predator earns profits on products other than the one that is sold at discriminatory prices -- not because the higher of the discriminatory prices subsidizes the lower one. B&W thus retreats from its contention that the difference between the high and low prices must "cause" the competitive injury -- a causation that B&W has denied when both the high and low prices are below cost. The most that price discrimination can do in any case is to facilitate predatory pricing by reducing its cost and therefore its risk. See Pet. Br. at 21 n.23, 27. B&W concedes as much. Resp. Br. at 29 n.24. Its counterargument that such discrimination made it cheaper for Liggett to resist is erroneous, for Liggett had to offer similar rebates over a then-larger volume of generics. In any event, the next text point is a dispositive answer.

⁵There, modest evidence of intent to harm a rival by planting a spy in its plant and referring to it as an "unfavorable factor in the market"; here, overwhelming evidence of unambiguous intent to harm both a rival and consumers, an express and sophisticated analysis of how to succeed in doing so, and a declaration of actual success. There, prices below some measure of cost for short periods; here, non-introductory, non-promotional prices below average variable cost for at least eighteen months. There, no entry barriers or persistent oligopoly with

Court to broaden the scope of liability in *Utah Pie*, Liggett asks this Court to reverse the Fourth Circuit on the basis of a rule far more demanding than that implicit in *Utah Pie*.

3. *Actual Effects*. Although both parties agree that the generic sector has expanded, B&W does not deny that all cigarette prices rose faster than costs or inflation -- 58% for generics and 32% for regular brands between December 1985 and December 1988. J.A. 325. But the generic sector did not expand *because of* B&W's below-cost pricing but in spite of it. B&W's conduct resulted in higher prices,⁶ which cannot increase demand and always constitute injury to consumers.

Slowing the growth rate of generics allowed B&W to recoup by protecting some supracompetitive, regular-brand profits from greater cannibalization than would otherwise have occurred. According to its own plans, B&W's objective was satisfied by slowing the growth *rate* for generics, a result

supracompetitive prices or other source of recoupment anticipated by defendants or otherwise; here, some \$350 million of recoupment sources by defendant's own calculation. There, no evidence that consumers ultimately paid higher prices; here, the relative price of the generic product rose and all prices rose more than costs or inflation. J.A. 747-49, 509-11, 514-26. Moreover *Utah Pie* cannot be limited to geographical discrimination. See Pet. Br. at 35; Liggett reply to B&W opposition to certiorari at 5.

⁶See *Standard Oil Co. of California v. United States*, 337 U.S. 293, 314 (1949) (Frankfurter, J.) (even if flourishing, competition might have been more vigorous in the absence of the challenged restraint). See also *Zoslaw v. MCA Distributing Corp.*, 594 F.Supp. 1022, 1033 (N.D. Cal. 1984). B&W seeks to bolster its rendition with material concerning matters occurring since the trial and even since the judgment. Such material was not, and could not be, in the record. This is a patent breach of appellate procedure that cannot be obscured by B&W claims that its incomplete rendition of non-record material is reliable. Resp. Br. at 16 n.10. Although it would be inappropriate to argue the point here, the non-record material actually shows consumer injury. See Liggett reply to B&W opposition to certiorari at 9 n.17.

that it admitted achieving.⁷ See Pet. Br. at 19. As the district court itself recognized during trial, "The slowing of the growth of the category gives recoupment in the branded sales retained, and a slowing of the growth of the segment can lessen the downward pull on the branded prices." Tr. 67:63.

In any event, an expectation of recoupment -- by the defendant at the time of below-cost pricing or by a court viewing the world as of that time -- can be eminently reasonable even if it turns out to be wrong. See Pet. Br. at 45-46. Contrary to B&W's assertion (Resp. Br. at 48), Liggett would not forbid looking at what actually happened in the marketplace to help interpret ambiguous conduct. But once conduct is sufficiently dangerous to be held illegal at the time it occurs, post-predation developments cannot erase the violation. The plain words of the statute condemn conduct that "may tend substantially to lessen competition" or, as the Court says, has the reasonable possibility of injuring competition. B&W asserts that the Fourth Circuit applied the "reasonable possibility test" but is unable to show where because that court never even stated, much less applied, that test.

B&W cites not a single case holding that subsequent events make conclusively lawful what would otherwise have been unlawful predation at the time it occurred.⁸ Nor does

⁷B&W now acknowledges that "every sale of a discounted cigarette puts a 'brake' on market prices by reducing demand for full-price brands." Resp. Br. at 16 n.11 (emphasis original). B&W thus recognizes that it recouped losses when Liggett increased its generic prices in June 1985 and thereafter, because a larger discount would have been a stronger brake. Indeed, B&W executives thought precisely in terms of "brak[ing] the growth of the generic segment." Tr. 61:233.

⁸*Boise Cascade Corp. v. FTC*, 837 F.2d 1127, 1144 (D.C. Cir. 1988), held only that the automatic inference of secondary-line injury to competition (among customers of a discriminating seller) that is drawn from the mere existence of price discrimination may be rebutted by actual evidence. As for *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340, 347 (3d Cir. 1981), cert. denied, 455 U.S. 1017 (1982), it was a case in which "[e]ven the most generous reading of the full record fails to disclose

B&W offer any reason for giving subsequent events that force. Despite B&W's dismissal of the law's educational function (Resp. Br. at 47-48), the law often seeks to deter dangerous conduct even if the danger does not materialize in a particular case.

4. *Policy.* It would indeed be bad policy to condemn aggressive price competition on the basis of an expressed intent to take business away from a rival. See Pet. Br. at 36-37. Such an intent is not anticompetitive. Moreover, the courts should not test the rough-and-tumble language of business people as if uttered by philosophers. It would also be bad policy "[i]f concentration is enough to put a 12% firm in danger for price cutting...." Resp. Br. at 32. But Liggett does not contend that concentration is enough, though B&W's economic expert conceded that industries as concentrated as the cigarette industry are very uncommon. J.A. 743-45.

Liggett's claim rests on unjustified discriminatory prices below average variable cost that create a genuine danger (which defendant expressly analyzed and concluded was likely) of disciplining a maverick discounter, increasing consumer prices, and protecting supracompetitive regular-brand profits. Moreover, Liggett's claim passed through powerful filters designed to protect price competition. See Pet. Br. at 42. The average-variable cost filter alone has proved a formidable and objective obstacle to excessive claims.⁹ Liggett respectfully submits that the Fourth Circuit

competitive harm," so that it would be purely "speculative" to assert that there might have been more competition. Here, the Fourth Circuit itself noted that the price discount had lessened, which necessarily reflects lessened competition.

⁹B&W's expert economist agreed that the average variable cost test is "a tough test for plaintiffs to meet." Tr.101:184. Amicus ITT urges the Court to rule that a price is not predatory when marginal revenue (not price) exceeds marginal costs. ITT br. at 9. Such a price is short-run profit maximizing and therefore not predatory. See P. Areeda & D. Turner, 3 *Antitrust Law* §715a (1978). It may therefore be useful as a defense in some circumstances. However, condemning as predatory all prices that are not short-run profit maximizing would increase, not reduce, liability. See *id.* at §713 and P. Areeda & H. Hovenkamp,

can be affirmed only if the Court concludes that (1) such filters are inadequate *and* (2) it is appropriate for the Court to immunize conduct that precisely fits the statutory words "may tend substantially to lessen competition."

5. *Jury Findings.* The jury answered "yes" to the specific question whether B&W "engage[d] in price discrimination that had a reasonable possibility of injuring competition in the cigarette market as a whole in the United States." J.A. 27. Instruction No. 12 defined "injury to competition" with reference to "loss-creating price cutting" and "recoup[ing] losses by raising and maintaining prices at higher than competitive levels." J.A. 830. Hence, the jury must have found a reasonable prospect of recoupment as well as below-average-variable-cost pricing, which was the only "loss-creating price-cutting" alleged in this case, discussed at trial, or mentioned in the instructions.¹⁰

While Instruction No. 18 allowed the jury to infer a reasonable possibility of injury to competition from "direct" evidence of "predatory intent," the jury was told that the only intent relevant to this case is one "in which a company plans to discipline...rivals...so that it can earn higher than competitive profits...." Inst. No. 19, J.A. 835.¹¹ The term

Antitrust Law, §714.2d (1992 Supp.), for a discussion of prices that should not be deemed predatory even though they fail to maximize short run profits. Moreover, short-run profit maximization will seldom be clear. Contrary to ITT, many of the classification problems associated with other cost tests remain.

In any event, that issue is not present here. B&W hired an expert accountant who testified at deposition that he would compare B&W's anticipated and actual marginal revenues and marginal costs. However, B&W never called the expert as a witness and objected strenuously when Liggett attempted to question B&W's expert economist about the results of that study. Tr. 101:172-79. Both parties requested instructions asking the jury to compare price with average variable cost.

¹⁰The district court judge correctly told counsel, "I'm not going to charge the jury. . . that they can find predation in this case, if there's above average variable cost pricing." Tr. 111:79.

¹¹In addition to Instructions No. 12 and No. 19, Instruction No. 30

"discipline" meant below-average-variable-cost pricing because that was the only disciplining at issue, and both parties agreed that such pricing was an essential element of predation.¹² In any event, B&W's own expert economists admitted that, apart from claimed tax-savings, B&W's generic prices were below average variable cost. *See infra* pp. 15-17.

Furthermore, contrary to B&W's repeated suggestion, many of its factual claims were necessarily rejected by the jury, which had been specifically instructed that it could absolve B&W of liability if (1) "competition actually increased," which could trump any inference of injury to competition drawn from either below-cost pricing or direct evidence of predatory intent (Inst. No. 20, J.A. 836); (2) B&W's pricing had been "a legitimate, competitive response to market conditions" (Inst. No. 19, J.A. 835), was "introductory" (Inst. No. 27, J.A. 842), or "motivated by a good faith effort to meet competition" (Inst. No. 34, J.A. 847); or (3) B&W "reasonably believed that its average

also contradicts B&W's repeated assertion that the jury could have based liability solely on "aggressive" language in B&W's documents: It specifically warned the jurors that "business people often use aggressive words to describe lawful competitive activities." J.A. 843-44. In any event, B&W documents analyzed in cool and calculated prose how below-cost pricing would cause Liggett to raise consumer prices for generics, thereby protecting regular-brand profits. Finally, the district judge's supplemental instruction did not "invite" a verdict based on bad intent alone. Resp. Br. at 9. That instruction stressed the need to read all the instructions as a whole. Tr. 123:27-30.

¹²For example, Liggett's closing argument was couched in those terms: "B&W's scheme was predatory. It intended to price its generic cigarettes below average variable cost in order to make Liggett bathe in red ink." Tr. 113:117. Moreover, under Instruction No. 16, J.A. 833, a finding of predatory intent was but one step in the process of inferring reasonable possibility of injury to competition, as defined by Instruction No. 12, J.A. 830. B&W complains that "the sole example of conduct given [in Instruction No. 29] was the alleged copying of Liggett's packaging" (Resp. Br. at 7), but the jury expressly found no infringement (J.A. 28) and therefore could not have based a finding of predatory intent on the alleged copying.

variable cost would not exceed its net prices" (Inst. No. 26, J. A. 841).¹³

6. *Keeping the Record Straight.*¹⁴ It is elementary that courts reviewing a judgment for defendant notwithstanding a jury verdict do not assess the evidence *de novo* but in the light most favorable to the non-moving party.¹⁵ *See* J. Friedenthal, M. Kane, & A. Miller, *Civil Procedure* 546-547 (1985). Nevertheless, B&W devotes the greater portion of its brief to rearguing the "facts" that it unsuccessfully presented to the jury. Though instructed by its parent company that it should "avoid price competition whenever possible" and that price cutting moves by others "should be countered swiftly and dominantly" (PX7098A, Tr. 47:53), B&W now attempts to transform itself into a champion of price competition and to portray the industry as the paradigm of robust competition. Although that attempt

¹³B&W's objection to the instruction requiring Liggett to prove that B&W had power in a cigarette market or generic submarket is irrelevant if this Court agrees that Robinson-Patman Act liability does not require single-firm domination of any market. The submarket instruction did not in any way lessen the required showing of a reasonable possibility of injury to competition in the cigarette market as a whole. J.A. 27.

¹⁴B&W seems to argue that even if a defendant's pricing is illegal and designed to weaken or discipline a rival in order to injure consumers later with higher prices, the victim lacks standing to recover its losses during the predatory period if it survives to benefit from later high prices. Resp. Br. at 45 n.34. But Liggett sought compensation only for the losses intentionally inflicted upon it by B&W's below-average-variable-cost price discrimination. Whether post-predation prices were optimal for Liggett (with its very small share of regular brands) was not litigated by either party. In any event, a rival's loss caused by the predator's below cost pricing always constitutes antitrust injury. *See Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 339 (1990) (victim of predatory pricing always suffers antitrust injury). *See* Pet. Br. at 46 n.58.

¹⁵Even if the instructions had allowed the jury to base liability on alternative theories, a reviewing court still assumes the non-moving party's account to be true when supported by the record, as it does at the directed verdict stage before any jury instructions or verdict. 5A J. Moore, *Moore's Federal Practice* ¶ 50.07 [2] at 50-81 (2d ed. 1992).

is not pertinent to the legal issues before this Court, B&W's extravagant factual claims cannot be left unanswered.

a. *Supracompetitive Profits.* B&W concedes that "cigarette industry profitability . . . remained high in the 1980's . . ." (Resp. Br. at 20 n.15),¹⁶ but then argues that Liggett executives demolished the premise of supracompetitive prices and profits by denying that the cigarette industry is a "collusive oligopoly" with "tacit collusion." Resp. Br. at 19. However, such testimony cannot preclude a reasonable jury from finding supracompetitive pricing. See Pet. Br. at 7 n.11. Compare Tr. 67:62-64 with Resp. Br. at 19 n.14. B&W also argues that the cigarette industry is not a stable oligopoly, citing gradual changes in market share and increasing couponing and other promotional programs. Resp. Br. at 11. However, changes in market shares are consistent with supracompetitive profits (*see supra* p. 3 n.2), and the promotional payments are fully accounted for within the industry's high profits. J.A. 508-09. Moreover, expenditures on such promotional payments have been greatly exceeded by price increases. *Id.* As to the article supposedly indicating that the cigarette industry is "at least moderately competitive" (Resp. Br. at 20, 38), it concludes only that the industry is not "a perfect cartel." D. Sullivan, *Testing Hypotheses About Firm Behavior in the Cigarette Industry*, 98 J. Pol. Econ. 586, 593 (1985).

Without denying that regular-brand profits are supra-competitive, B&W asserts that "the \$350 million is a pre-Doral estimate of the profit B&W would lose if it did not go into generics" (Resp. Br. at 25), suggesting that the \$350 million represents potential profits *on* generic sales. That is contrary to the plain meaning of B&W's contemporaneous documents, which project losing \$350 million in regular-brand revenue *to* generics through 1988:

¹⁶The intangible value of brand names does not explain profits exceeding those in the food and kindred products group, where valuable brand names also abound. In any event, the supracompetitive profits of the cigarette industry are inferred from far more than high accounting rates of return. See Pet. Br. at 5-7.

In 1983 B&W lost about 3.7 billion sticks to generics, a variable margin loss of over \$50 MM. By 1988, this could total 18 billion sticks and about \$350 MM lost variable margin. J.A. 83.

The repricing of Doral did not lead B&W to lower that \$350 million estimate. J.A. 138.

b. *B&W's Unwavering Plan.* Ignoring its concession in the Fourth Circuit that its plan was anticompetitive¹⁷ and ignoring the district court's strong conclusion that B&W's anticompetitive intent was clearly documented (Pet. App. at 31a), B&W now argues that it "did not plan to injure competition." Resp. Br. at 16. B&W now claims that after R.J. Reynolds repositioned Doral, it abandoned whatever predatory intent it may have had in early 1984. In fact, B&W's post-Doral business plan expressly confirmed that B&W's "[p]lan of action to be followed is exactly as our previous proposal outlined." J.A. 121. B&W saw no reason to change its previous plan given that, as B&W concluded, black-and-whites would continue to grow and Liggett would still need to be disciplined because R.J. Reynolds -- though its objective was consistent with B&W's to manage the price of generics upward -- could not be expected to discipline Liggett. See Pet. Br. at 11-12, 17. Significantly, B&W does not and cannot point to a single respect in which its post-Doral conduct differed from its pre-Doral plan.

B&W complains that "Liggett seizes on two phrases in a rough, handwritten note by a Ms. Tharaldson (J.A. 61), a seventh-tier (two from the bottom of the sales hierarchy) manager (PX 27; Tr. 2:198-99), that B&W could 'signal' to competition that it would not expand the generic segment and wished to 'put a lid on Liggett.'" Resp. Br. at 17. But

¹⁷When the court asked whether B&W "intended to monopolize, but flopped," B&W's counsel replied that if the plans and predictions set forth in B&W's documents had materialized "they [Liggett] would have a case against us for predatory pricing." Oral Argument Tr. at 33-34.

B&W's minimization of her role is incorrect,¹⁸ and B&W cannot deny that her notes are fully consistent with B&W's strategy documented at the company's highest levels.¹⁹

c. *Price Discrimination Unjustified.* B&W denies neither that discrimination played an important role in its planning nor that its rebates were unprecedentedly large. Instead, B&W tries to portray Liggett as the aggressor in the so-called rebate war, ignoring its own contemporaneous documents. B&W's Final Proposal to its parent company expressly conditioned the launch of its black and white cigarettes on "[s]uperior discounts/allowances." J.A. 142. Moreover, B&W predicted that Liggett would respond to B&W's announced rebates by increasing the size of its own rebate: Liggett "can be expected to minimally match the competitive offer." J.A. 91. In every volume category except the smallest, B&W's rebate offers exceeded Liggett's, and B&W continued to increase its rebates even though Liggett *never* met B&W's rebate at any time during the so-called rebate war. J.A. 327-28. The jury explicitly found that B&W did not "engage in price discrimination in good

¹⁸Ms. Tharaldson reported directly to D.P. Christensen, the Director of National Sales Development (the number three position in the sales side of B&W) (Tr. 71:158-59); was a hand picked member of the Generic Task Force formed to investigate and plan for B&W's entry into generics (Tr. 71:163); and gave deposition testimony that in developing B&W's plan to enter the generic segment, she worked directly with such high level officers within B&W as Mr. Alar (Vice Chairman of the Board), Mr. Sandefur (President), Mr. Butler (Vice President of Sales), Mr. Parrack (Vice President of new products), Mr. Heger (Senior Vice President Finance and Planning) and Mr. Bacon (Controller). (She claimed to have no knowledge of the contents of her own handwritten notes, to the expressed disbelief of the trial court judge. Tr. 35: 127-28). (Because her notes (J.A. 60) first became an exhibit at the deposition of Olges, they remained marked as "Olges 15," causing the inadvertent reference to Olges in the table of contents to the joint appendix.)

¹⁹B&W's "pro-forma" profit and loss statement accompanying its Final Proposal to BATUS which assumed that the generic discount would remain at 35% confirms B&W's anticompetitive objective of preventing a widening of the discount gap. Moreover, B&W's subsequently approved 1986-1990 corporate plan projects the discount narrowing from 38% in 1985 to 28% in 1990. J.A. 283.

faith with the intention to meet" competition with Liggett. J.A. 27-28.

B&W's repeated characterization of the rebate war as normal price competition ignores the facts that no other firm participated in the so-called war and that B&W priced well below average variable cost for 18 months. See Pet. Br. at 13-14, 18.

d. *Prices Below Average Variable Cost.* The admissions of B&W's two economic experts to the direct, non-hypothetical question, "Did B&W price above or below average variable cost in 1984 and 1985," are dispositive. J.A. 651, 740.

B&W argues that those admissions ignore "an important source of cost savings that B&W realized because of tax reductions due to additional sales volume and its LIFO accounting system," in the light of which "B&W clearly did make very substantial profits on its generics." Resp. Br. at 23-24. However, the argument fails legally and factually. Even if B&W's entry into generics achieved such savings, it does not argue that its entry required pricing below average variable cost. Moreover, a tax deduction cannot transform an otherwise predatory price into a lawful one. See Pet. Br. at 14 n.16. Furthermore, B&W cites no record evidence of such savings,²⁰ and its own controller testified that purchasing the leaf cost more than any tax benefits were worth. Tr. 98:187, 192, 194. Finally, B&W unsuccessfully made its tax-savings argument to the jury, which was permitted to "reject an inference of predatory intent" if tax benefits were "a substantial motivation" for B&W's entry into generics. Inst. No. 28, J.A. 842.

B&W complains that the eighteen month period at issue was "artificially" or "arbitrarily" selected by Liggett. Resp.

²⁰Its claim that Liggett's expert conceded the existence and relevance of such savings is wrong. Liggett's expert only agreed with the cross-examiner's redundancy that if tax savings exceeded losses, then losses would be less than savings. Tr. 57:135-36.

Br. at 22 n. 17, 24. In fact, those eighteen months covered the entire time from B&W's entry to the pre-trial cut-off of discovery -- a date requested by B&W over Liggett's objection. B&W Memorandum, Fourth Circuit Docket No. 316. Moreover, B&W's own expert economist characterized the eighteen month period as a "fairly long time period of analysis" for purposes of the average variable cost test. Tr. 102:67-68. Furthermore, B&W made its unreasonable-time-period argument to the jury which was told to consider it. Inst. No. 25, J.A. 840.

B&W also argues that it "made profits on black-and-whites in seven scattered months of that period, and its black-and-whites were profitable when viewed over the twenty four-month period following their introduction." Resp. Br. at 24. But B&W fails to disclose that it is not writing about "profits" in the usual sense but about what it calls "trading profit," which measures the difference between total revenue and certain (*but not all*) variable costs. See e.g., Tr. 62:78. Trading profit does not take into account certain major admittedly variable costs such as the costs associated with maintaining tobacco leaf and other supplies in inventory. Tr. 101:202, Tr. 62:40. When all variable costs are counted, B&W priced below average variable cost in each of the 18 months from its first shipment of generics until the close of discovery. PX 3952 R, 3956 R, Tr. 48:27. Moreover, when B&W asserts that in the 18 month period "it fell . . . 1% short of break even" it again fails to disclose that it is not using total cost or even average variable cost as the "break even" point but an arbitrary internal accounting measure of some but not all variable costs. In fact, B&W fell approximately 20% below average variable cost for the 18 month period. J.A. 338.

Finally, B&W argues that even if it did sell at prices below average variable costs, it did not *intend* to set its prices as low as it did set them. But not even B&W claims that it set its prices by mistake for eighteen months. Moreover, a price-cost test would be meaningless if a defendant could avoid its reach merely by claiming that it lowered its prices in response to "market conditions." Once a defendant persistently prices below average variable costs, an asserted

earlier hope, later abandoned, of remaining above costs does not immunize sustained below-cost pricing.²¹

e. *Liggett Disciplined*. B&W studiously ignores its own documents predicting that it could force Liggett to raise list prices. See Pet. Br. at 15-16. Moreover, the district judge stated in denying B&W's motion for a directed verdict, "the ability of [Liggett] to compete and to offer consumers a lower price had been compromised. [B&W] recognized this in their own documents in evidence."²² Tr. 67:64.

B&W's argument that Liggett "surrendered" in March 1984 before B&W entered the segment ignores the context. Liggett's March 1984 generic price increase was a delayed response to the 1983 federal excise tax increase of \$4 per thousand. While all cigarette manufacturers responded by increasing list prices on regular brands by more than \$4, Liggett raised its generic prices only \$2 then and another \$1.50 in 1984. With all price changes taken into account, the discount gap widened to 37.8% by June 1984. J.A. 325.

²¹B&W does not fall within the qualification that permits an expanding firm that "reasonably anticipates" declining manufacturing costs, to rely on those lower anticipated costs -- rather than its higher present costs -- when it sets its prices. See P. Areeda & D. Turner, 3 *Antitrust Law* ¶ 715d at 175 (1978). As a matter of fact, moreover, B&W errs in asserting that its intention to remain at "full variable margin" shows a plan to price above costs. Even under the interpretation most favorable to B&W, spending "full variable margin" would mean zero "trading profit" (Resp. Br. at 22), which necessarily means pricing below cost as explained above. Thus, even if the financial schedule attached to B&W's Final Proposal showed zero "trading profits," it does *not* mean that B&W intended to remain above average variable cost. As B&W's contemporaneous documents made quite clear, B&W was "not going into it [black-and-whites] with the objective to make a profit." J.A. 174. See also J.A. 53; Tr. 62:36-43, 49-60, 74-79, J.A. 663-67.

²²B&W cites a 1981 Liggett document purporting to say that Liggett wanted to close the discount gap to 24% by August 1985. Resp. Br. at 27 (citing DX 36R at AB 173157, Tr. 68:163). The reference to a 24% gap is merely an assumption of what would happen if the *dollar* amount of the discount were to remain constant while regular-brand prices predictably increased.

Further, B&W contends that Liggett's price increase in 1985 was a mere bookkeeping surrender because Liggett increased its rebates at the same time. That contention ignores B&W's own distinction (which its brief does not retract) between higher rebates that would not benefit consumers and higher list prices that would burden consumers and narrow the gap. *See* Pet. Br. at 10. To be sure, Liggett did increase its rebate by a proportionate amount to a few large customers in order to keep their business, but that did not prevent consumer prices from rising.

Nor is B&W correct when it asserts that "the one time B&W initiated a generic price increase, Liggett did not follow." Resp. Br. at 26. After Liggett resisted a B&W price increase in December 1985,²³ B&W increased black-and-white prices three more times before trial and Liggett followed each time.²⁴ J.A. 295-302, 304-307.

²³B&W asks, "If Liggett easily 'resisted' B&W's attempted increase at the very end of the alleged 'period of predation' [December 1985], why would it 'follow' B&W increases thereafter?" Resp. Br. at 26. December 1985 was not the end of the period of predation, but merely the cut-off of discovery, and thus Liggett was unable to establish how long after December 1985 B&W continued to price below average variable cost.

²⁴B&W claims that Liggett "simply made up" the fact that it followed B&W's lead in raising prices in 1986, 1987, and 1988. Resp. Br. at 26. The record shows that on June 12, 1986, B&W signaled its intent to raise generic prices by informing all distributors that they could only purchase a limited number of cigarettes at the current price. J.A. 295. On the next day, Liggett increased its generic prices. J.A. 297. On December 4, 1987, B&W increased generic prices by \$2.75. J.A. 299. On December 8, 1987, Liggett followed with a \$2.50 price increase. PX 2080, Tr. 60:63, partially reprinted at J.A. 301. On June 16, 1988 B&W initiated a \$2.75 increase, and on June 17 Liggett followed. J.A. 304-306.

f. *Fellow Oligopolists.* B&W continues to ignore its contemporaneous documents that anticipated its fellow oligopolists' likely entry into generics and analyzed their common interest in narrowing the discount. Instead, B&W merely argues that, because Liggett and R.J. Reynolds had used volume rebates in the economy segment, B&W's volume rebates could not have been a "signal" that B&W had no intention of expanding the segment. However, Liggett's and R.J. Reynolds' small volume rebates before B&W's entry does not change the fact that B&W's documents emphasized that rebates, unlike list-price reductions, would not be passed on to the consumer and therefore would not expand the economy segment.²⁵ *See* Pet. Br. at 10. Moreover, B&W's volume rebates dwarfed all previously existing rebates. *See id.* at 8 n.12.

g. *Higher Prices.* B&W denies neither that the discount between generic cigarettes and full revenue cigarettes fell from 40% in 1985 to 27% in 1989 nor that all prices rose. Thus, consumers paid more for both generic and branded cigarettes. The only exception resulted from Liggett's introduction of a so-called subgeneric cigarette, Pyramid, in December 1988 at the same list price that it had been selling generic cigarettes before B&W's entry. Although during trial four other manufacturers came to imitate Liggett's Pyramid, the subgenerics still accounted for only a small portion of generic volume. J.A. 290, 348. Moreover, by relying on subgenerics as evidence of competition, B&W effectively acknowledges that its 1984-85 below-cost, discriminatory rebates on black-and-whites deprived consumers from mid-1985 until the end of 1988 of the opportunity to purchase cigarettes at the deep discount that Liggett had provided before it was disciplined.

B&W minimizes its contemporaneous claim of credit for slowing the growth rate of the segment, saying that "the

²⁵That Liggett's expert claimed "no tacit collusion in the generic segment during the alleged period of predation" (Resp. Br. at 19) correctly indicated merely that B&W acted independently in disciplining Liggett. After all, the other firms did not then sell black-and-whites or participate in B&W's unprecedented rebates.

rate of growth necessarily slowed because of the larger base against which growth was measured." Resp. Br. at 27. But its claiming credit for that development shows, as the district court observed in denying a directed verdict, that B&W's "own executives . . . thought it was not only a possible or plausible scenario but that, in fact, what they said they were going to do and wanted to do succeeded or was succeeding." Tr. 67:64.

For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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March 1, 1993

No. 92-466

Supreme Court, U.S.

FILED

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1992

LIGGETT GROUP INC.,
now named Brooke Group Ltd.,
v. *Petitioner,*

BROWN & WILLIAMSON TOBACCO CORPORATION,
Respondent.

On Writ of Certiorari to the
United States Court of Appeals
for the Fourth Circuit

BRIEF OF
GROCERY MANUFACTURERS OF AMERICA, INC.
AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

Whether the Fourth Circuit correctly affirmed the district court's determination that Liggett failed to establish that, in the absence of collusion or monopoly power, the unilateral decision of a competitor having less than a twelve-percent market share to compete by cutting price did not create a "reasonable possibility" of competitive injury because the strategic reaction of other competitors in the market could not be assumed and because competition within the stipulated relevant market was not, and could not have been, injured.

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IN THE
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LIGGETT GROUP INC.,
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Respondent.

**On Writ of Certiorari to the
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for the Fourth Circuit**

**BRIEF OF
GROCERY MANUFACTURERS OF AMERICA, INC.
AS AMICUS CURIAE IN SUPPORT OF RESPONDENT ¹**

THE INTEREST OF AMICUS CURIAE

The Grocery Manufacturers of America, Inc. ("GMA") is a non-profit voluntary business association incorporated under the laws of Delaware. GMA represents more than 130 companies that manufacture and distribute products primarily sold in retail grocery stores throughout the United States.² These generally include both "branded"

¹ Petitioner and Respondent have both consented to the filing of this brief; the written consents are on file with the Clerk.

² Among GMA's members are many of the best known grocery manufacturers in the United States participating in such diverse markets as frozen, refrigerated, shelf-stable, and fresh foods, bakery

and "generic"³ products. GMA's member companies employ more than 2.5 million people and have annual sales of more than \$250 billion.

GMA and its members have had a longstanding, keen interest in matters relating to the sale and distribution of products sold in retail grocery stores in the United States. This includes the interpretation and enforcement of the federal antitrust laws, especially the Robinson-Patman Act. The Robinson-Patman Act was enacted in 1936 at the behest of a wholesale grocers' association to address alleged pricing abuses in the grocery manufacturing industry.⁴ Since the Act's adoption, numerous cases have been brought that involve this industry. Indeed, the grocery manufacturing industry can be viewed as the Act's "test tube"; many of this Court's Robinson-Patman Act opinions involve grocery products.⁵

In this connection, GMA believes that vigorous price (and non-price) competition should be encouraged in an environment where the rules regulating such competition are clear, predictable, and rational. This is particularly true in an industry like the grocery industry: Branded products compete with other branded and generic products

products, beverages, paper products, dairy products, cereals, snack foods, toiletries, household cleaning products, etc.

³ As used herein, "generic" includes store brands, private label, and black-and-white non-branded products that are usually sold off the store shelf at prices lower than branded products intended for the same use.

⁴ See generally *In re General Motors Corp.*, 103 F.T.C. 641, 691 (1984). See also F. Rowe, PRICE DISCRIMINATION UNDER THE ROBINSON-PATMAN ACT 11-23 (1962).

⁵ See, e.g., *Great Atlantic & Pacific Tea Co. v. FTC*, 440 U.S. 69 (1979); *FTC v. Fred Meyer, Inc.*, 390 U.S. 341 (1968); *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967); *FTC v. Borden Co.*, 383 U.S. 637 (1966); *United States v. Borden*, 370 U.S. 460 (1962); *Moore v. Mead's Fine Bread Co.*, 348 U.S. 115 (1954); *FTC v. Morton Salt Co.*, 334 U.S. 37 (1948).

each and every day and price competition is multifaceted. In the grocery manufacturing industry, as in the cigarette industry, there are list prices which are affected by rebates, coupons, volume discounts, shelf payments, etc. This makes pricing decisions complicated, but critical to the competitiveness of the industry. To expose countless pricing and competitive decisions in industries that are arguably moderately concentrated to treble damage liability based on a claim that they were made with "predatory intent," as Liggett proposes, would have a severe chilling effect on the very price-cutting decisions that lie at the heart of the competitive process and that result in benefits to consumers.

GMA's particular interest in this case arises from its belief that the ramifications of this particular antitrust decision are likely to extend well beyond the specific facts before this Court and affect the efficient operation of our economy and legal system. Petitioner Liggett has advanced a novel theory of Robinson-Patman Act liability that was rejected on factual, legal, and economic grounds by the courts below. GMA is concerned that adoption of Liggett's theory will not only encourage unsound Robinson-Patman Act treble damage litigation, but will create a great deal of uncertainty with respect to pricing decisions in industries, such as grocery manufacturing, where branded products compete vigorously among themselves and with generic products for acceptance by consumers and where volume discounts are prevalent. This would ultimately result in increased costs to consumers for basic needs. GMA (and its members) therefore has a substantial interest in this case.

STATEMENT

Brown & Williamson Tobacco Corporation ("B&W") and Liggett Group Inc. ("Liggett") are, among other things, two of the smaller manufacturers of cigarettes. Both companies distribute cigarettes through wholesalers and directly through retailers, and both companies com-

pete nationwide with the much larger (in terms of cigarette sales) Philip Morris U.S.A. and R.J. Reynolds Tobacco Company ("RJR"), as well as Lorillard, Inc. and American Tobacco Company. Pet. App. at 20a-21a.⁶

In 1980, Liggett was the first of the major U.S. cigarette manufacturers to enter the relatively new "generic" segment of the cigarette market by providing a grocery chain with its own private-label cigarettes. Liggett later began offering unbranded or "black and white" generics (so-called because the cigarettes are sold in plain white packages with black lettering indicating the type of product) at volume discounts. *Id.* at 21a. As noted by the trial court, "[g]eneric cigarettes were an unqualified success for Liggett. The segment grew steadily, and by mid-1984 generic sales accounted for 4.1% of the total United States cigarette business with Liggett holding *ninety-seven per cent (97%) of the segment.*" *Id.* (emphasis added).

In 1983, first RJR and later B&W responded to the growing competition from generics by offering value-priced branded generics. RJR marketed "Century" with 25 cigarettes per pack (in contrast to the usual 20-cigarette pack). B&W sold "Richland," also with 25 cigarettes per pack. *Id.*

The competition continued. In May 1984, RJR attempted to counter the increased popularity of generics: it "repositioned" its full-price brand, "Doral," by matching the list prices of Liggett's generics and by offering volume discounts greater than Liggett's. *Id.* at 21a-22a, and n.12. Responding to the competition, B&W made plans to offer black and white, additional value-priced branded, and private label generics. But B&W's parent, BATUS, approved only the sale of black and whites and directed B&W to make a profit. Jt. App. at 442.

⁶ The following citation abbreviations are used in the brief. "Pet. App." refers to the Appendix to Liggett's Petition; "Pet. Br." refers to Liggett's Brief on the merits; and "Jt. App." refers to the Joint Appendix filed with this Court by the parties.

Later in May 1984, B&W announced the intended introduction of its new generics along with proposed list prices and discount schedules. Pet. App. at 22a. In response to this announcement, Liggett immediately increased both its discounts on and promotion of generics. Competitive volleys continued. B&W responded with further discounts, which provoked another response from Liggett. There were five rounds of price cuts—all before B&W actually began shipping its new generic products. *Id.* at 5a. The record evidence establishes that B&W increased its discounts only in response to similar increases by Liggett. *Id.* at 21a-22a. By the time of trial, sales of generic cigarettes had increased dramatically, from approximately 2.8 billion cigarettes sold in 1981 to 61.6 billion cigarettes sold in 1988. *Id.* at 6a.

Liggett, perhaps tired of competing and preferring to litigate, brought this action against B&W in the midst of this "price war." *Id.* at 5a. It initially alleged that B&W had infringed its trademark and had competed unfairly. (It made no Robinson-Patman Act claim at that time.) In the quest for the Golden Fleece of treble damages, Liggett later added a Robinson-Patman claim alleging that B&W had illegally discriminated in price between full-price branded cigarettes and black and white generics. Still in search of a theory, Liggett amended its complaint yet again to allege that the illegal discrimination stemmed from volume discounts on black and white generics alone. *Id.* Before trial, the district court granted partial summary judgment to B&W on the claim that it illegally discriminated between full-price branded and generic cigarettes. After trial, a jury returned a verdict for Liggett on the surviving Robinson-Patman claim and for B&W on the remaining claims. The court then granted B&W's motion for judgment n.o.v. *Id.* at 52a.

The district court set aside the Robinson-Patman Act verdict based on Liggett's failure to establish the requisite elements of its claim, to wit: (1) primary-line com-

petitive injury; (2) a causal link between the alleged discrimination and any competitive injury; and (3) anti-trust injury. *Id.* at 24a. Liggett appealed. The court of appeals affirmed the district court's ruling, concluding that Liggett was unable to demonstrate competitive injury since it could not factually support its novel theory of "oligopolistic recoupment." *Id.* at 12a.

Liggett petitioned this Court for a writ of certiorari, presenting three questions for resolution. Unfortunately, these questions have nothing to do with this case. Each of Liggett's hypothetical questions could be answered in its favor without providing any basis for disturbing the rulings below. The court below did *not* decide, as Liggett contends, that the Robinson-Patman Act does not retain "independent force" from the Sherman Act; it did *not* supplant a jury verdict with its own "theoretical speculations"; and it did *not* purport to require actual damage instead of a reasonable threat of injury. Rather, the court of appeals specifically found that this Court's leading primary-line Robinson-Patman Act decision, *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967), was distinguishable on its facts. It also found that the record evidence (such as the tremendous growth of the generic segment after B&W's alleged predation) undermined Liggett's theory-based claim that B&W could reasonably expect "recoupment." The court of appeals did not even discuss any requirement of actual damage, much less supplant the lesser "reasonable threat to injury" standard posited by Liggett.

SUMMARY OF ARGUMENT

This Court traditionally has—quite correctly—required lower courts to examine closely complaints by companies that a competitor has engaged in predatory (*i.e.*, too low) pricing. Low prices benefit consumers, and legitimate price-cutting is hard to distinguish from predatory pricing. Liggett espouses a novel theory of predatory

pricing that would impose liability on a company with less than a twelve-percent market share that made unilateral price-cuts to compete with the established company in a market segment. This theory, however, was rejected on factual, legal, and economic grounds by the courts below. In industries like grocery and cigarette manufacturing, competition can take a variety of forms—myriads of decisions are made on virtually a daily basis with respect to coupons, rebates, volume discounts, shelf payments, product differentiation, etc. The rules relating to these decisions must be clear, predictable, and rational. Adoption of Liggett's theory would seriously undermine these important goals and penalize companies that unilaterally analyze potential market reaction to their competitive actions. It would also unnecessarily discourage price-cutting to the detriment of consumers.

ARGUMENT

I. PREDATORY PRICING SCHEMES ARE EXTREMELY SPECULATIVE; THIS COURT SHOULD RETAIN ITS HEALTHY SKEPTICISM OF SUCH CLAIMS.

This case involves allegations that B&W priced its generic products too cheaply. In this regard, the Seventh Circuit recently observed, "courts should treat with great skepticism complaints by competitors who are injured by the low prices that customers adore, when the customers are content." *A. A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396, 1403-04 (7th Cir. 1989), *cert. denied*, 494 U.S. 1019 (1990).

The Seventh Circuit's teaching was informed by this Court's decision in *Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), where this Court described the key rationale for the doubts surrounding claims of predatory (too low) pricing schemes: "[T]he success of such schemes is inherently uncertain: the short-run loss is definite, but the long-run gain de-

depends on successfully neutralizing the competition” *Id.* at 589.

GMA submits that this Court’s healthy skepticism of predatory pricing claims by competitors is appropriate. First, decreased prices benefit consumers. That benefit is tangible and immediate. The harm sometimes associated with “too low” prices is both highly speculative and prospective. As this Court explained:

A predatory pricing conspiracy is by nature speculative. Any agreement to price below the competitive level requires the conspirators to forego profits that free competition would offer them. The foregone profits may be considered an investment in the future. For the investment to be rational, the conspirators must have a reasonable expectation of recovering, in the form of later monopoly profits, more than the losses suffered

Id. at 588-89. The Court noted, “[t]hese observations apply even to predatory pricing by a *single firm* seeking monopoly power.” *Id.* at 590 (emphasis in original).

Second, without clear *a priori* guidelines, companies would enter into procompetitive “price wars” at their peril. Liggett itself recognizes that there is an extremely fine line between legitimate pricing behavior and predatory pricing. (Pet. Br. at 41). Predatory pricing claims therefore are particularly susceptible to having a factfinder accept a “false positive”—what statisticians refer to as committing a Type II error.⁷ Mischaracterization of vigorous price competition as predatory pricing not only

⁷ When interpreting data to test a hypothesis, statisticians commonly refer to two types of errors that occur as Type I and Type II errors. Type I errors are false negatives—the improper rejection of the truth. Type II errors are false positives—the improper adoption of a falsity. See M. Kendall & W. Buckland, A DICTIONARY OF STATISTICAL TERMS, 66 (4th ed. 1982).

unfairly imposes antitrust liability (and litigation costs) on a competitor, but ultimately denies consumers the fruits of a keenly competitive marketplace.

Many commentators have, in fact, argued that predatory pricing is not as prevalent as believed and that courts have condemned improperly as “predatory pricing” legitimate price competition.⁸ Indeed, this Court observed:

[T]he mechanism by which a firm engages in predatory pricing—lowering prices—is the same mechanism by which a firm stimulates competition; because “cutting prices in order to increase business often is the very essence of competition . . . [;] mistaken inferences . . . are especially costly, because they chill the very conduct the antitrust laws are designed to protect.”

Cargill Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 121-22 n.17 (1986) (citing *Matsushita*, 475 U.S. at 594). GMA submits that, on balance, it is sound antitrust policy to attempt to fashion the antitrust rules applicable to predatory pricing in a way that reduces the chance of “false positives” and thereby avoid the unnecessary chilling of procompetitive price-cutting.

Third, the ability of a competitor to employ diverse and flexible pricing strategies is critical to the workings of a competitive U.S. economy. Flexible pricing strategies are, in fact, the cornerstone of a free market. This is especially true in markets, such as cigarette and grocery manufacturing, where competition can be fierce and multifaceted—long established name brands may face

⁸ See, e.g., Koller, *The Myth of Predatory Pricing: An Empirical Study*, 4 ANTITRUST L. & ECON. REV. 105 (Summer 1971) (examining data on 26 findings of liability for predatory pricing and discovering only three instances of sales below cost with predatory intent that caused a misallocation of resources). See also McGee, *Predatory Price Cutting: The Standard Oil (N.J.) Case*, 1 J.L. & ECON. 137 (1958); Elzinga, *Predatory Pricing: The Case of the Gunpowder Trust*, 13 J.L. & ECON. 223 (1970).

erosion in sales because of increased sales of other name brands or generics—and where consumer demand may change rapidly and without warning because of changes in taste and lifestyles.

For example, well-known brand name canned vegetables compete with other brand name canned vegetables and generic (including grocery store private label) canned vegetables. With increased emphasis on frozen foods, canned vegetables have seen a significant erosion of sales to frozen vegetables. (Canned vegetables also compete, of course, with fresh vegetables.) Competition in this industry is dynamic, multidimensional, and intense. Companies in this industry must quickly respond to competitive conditions, including rapid changes in consumer tastes or the introduction of new or differentiated products. Innumerable decisions have to be made on a daily basis with respect to such things as coupons, rebates, stickers, volume discounts, shelf payments, and attempted product differentiation. Such actions should not require an attorney in every product manager's office. The antitrust treatment of unilateral pricing decisions must, therefore, take account of this vital need to respond to market conditions.

Fourth, this Court has generally—and quite properly—required close scrutiny of antitrust complaints by competitors. *E.g.*, *Matsushita*, 475 U.S. 574; *Cargill*, 479 U.S. at 121 n.17 (“[c]laims of threatened injury from predatory pricing must, of course, be evaluated with care”). A competitor has a keen interest in chilling vigorous and flexible price (or non-price) competition.

It is for this reason that aggressive statements of intent directed at a competitor should also be questioned, if not completely ignored, in cases brought by another competitor. As the Seventh Circuit noted in *A.A. Poultry*, “[f]irms ‘intend’ to do all the business they can, to crush their rivals if they can. . . . If courts use the vigorous, nasty pursuit of sales as evidence of a forbidden ‘intent’,

they run the risk of penalizing the motive forces of competition.” 881 F.2d at 1401-02 (citations omitted). In fact, the Seventh Circuit noted with approval that Liggett's counsel has advocated ignoring statements of intent in predatory pricing cases brought by competitors. *Id.* Despite these sound reasons for ignoring such evidence in cases like this one, Liggett's case revolves around B&W's statements of its alleged intent. *See, e.g.*, *Pet. Br.* at 34-35, 42. Indeed, the jury instructions permitted the jury to find for Liggett based on statements of intent alone.⁹

Apart from Liggett's misplaced and inappropriate reliance on statements of alleged “predatory intent,” this case presents a particularly appropriate forum for skepticism. Despite over 100 years of experience with the Sherman Act (which has been used to challenge predatory pricing) and over 55 years of experience with the Robinson-Patman Act (under which Liggett brought the claim at issue), Liggett's theory is admittedly novel.¹⁰ Moreover, Liggett's lawsuit is a thinly-veiled response to contemplated entry; Liggett commenced this action promptly in response to B&W's announced plans to enter a segment of the cigarette market then-dominated by Liggett. Indeed, it was not until B&W moved for summary judgment that Liggett invented the theory underlying the claim now before this Court.

⁹ The jury was not required to find that competitive injury resulted from B&W actually engaging in predatory (below cost) pricing; it was permitted to find such injury based solely on B&W's statements of intent. *See Pet. Br.* at 19.

¹⁰ Liggett has widely publicized the novelty of its argument before this Court, as well as its far-reaching implications. *E.g.*, Rushford, *Attack of the Killer Antitrust Lawyer; Patton, Boggs' Rasmussen Aims Bold Theory at Market Concentration, and Rakes in the Fees*, *LEGAL TIMES* (Sept. 17, 1990), at 1.

II. THE COURTS BELOW PROPERLY REJECTED LIGGETT'S THEORY OF RECOUPMENT.

The courts below each found that Liggett had failed to establish the requisite elements of its Robinson-Patman claim; the district court pointed to several deficiencies while the court of appeals focused on one—the failure of Liggett to show, as a matter of fact, law, and economics, that B&W could “reasonably expect” to recoup any losses it incurred by predatory pricing.

This Court recognized the necessity of recoupment in *Matsushita* and *Cargill*. Because of the highly speculative nature of predatory pricing, the Court in *Matsushita* upheld summary judgment for defendants because it found that they lacked a “reasonable expectation” of later recovering the losses that they allegedly would incur as a result of the predatory pricing conspiracy. 475 U.S. at 589. This Court recognized that, without such an expectation of “recoupment,” a predatory pricing scheme would not be economically rational.¹¹ The Court then held that, as a matter of law, it would be inappropriate to draw inferences from evidence that would require irrational conduct. *Id.* at 593. *See also Cargill*, 479 U.S. at 119-20 n.15 (“[c]ourts should not find allegations of predatory pricing credible when the alleged predator is incapable of successfully pursuing a predatory scheme”). As discussed below, this is precisely what the courts below determined, *i.e.*, Liggett had failed to proffer any evidence that would show a reasonable likelihood that B&W could conduct a successful predatory pricing scheme. Perhaps as important, the jury was not required to make any such finding—it was permitted to find for Liggett based on statements of intent alone.

In a “traditional” predatory pricing claim, the expectation of recoupment comes from the predator’s anticipation

¹¹ Liggett does not dispute that a “reasonable expectation” of recoupment is a requirement of a predatory pricing claim. Pet. Br. at 23-24.

that it will possess monopoly power after it has driven out its competitor. The predator can then raise prices to monopoly levels to recoup its earlier losses. Even in a monopoly situation, recoupment is far from certain. As this Court has explained:

[I]t is not enough simply to achieve monopoly power, as monopoly pricing may breed quick entry by new competitors eager to share in the excess profits. The success of any predatory pricing scheme depends on *maintaining* monopoly power for long enough both to recoup the predator’s losses and to harvest some additional gain.

Matsushita, 475 U.S. at 589 (emphasis in original).

Here, the “traditional” monopoly model does not work—B&W possessed less than 12% of the relevant market. In light of the existence of much larger competitors, B&W could never recoup its alleged losses because it lacked the power, acting alone, to maintain an increase in prices. But act alone B&W must, since there is no allegation nor finding that B&W acted in combination with its larger competitors. Indeed, Liggett’s own economic expert conceded that there was no collusion, tacit or otherwise, in the generic segment of the cigarette market. Pet. App. at 36a.

Liggett therefore was faced with devising a theory that would permit recoupment by B&W. It concocted a theory *never before* used—B&W, acting unilaterally, could reasonably expect to recoup its losses from its alleged predation because the cigarette market is oligopolistic and B&W could count on the other participants to act in a manner that would allow its recoupment scheme to be effective. Specifically, the other competitors would not do anything that would further increase competition in the generic segment, thereby allowing B&W to “discipline” Liggett and recoup its losses from the branded segment. Put most charitably, Liggett argues that B&W possessed the omniscience to incur losses associated with

price predation because it could predict with sufficient certainty that its competitors—similarly omniscient—would not either (a) misperceive B&W's "disciplinary" conduct directed at Liggett as an effort to grab market share or (b) decide that some other action that would frustrate B&W's plan are in their own best interests.¹²

Acceptance of Liggett's theory of oligopolistic behavior would set dangerous precedent. It fails to account for the fragility of any *expectation* about competitors' behavior. In the context of an alleged *express* predatory pricing conspiracy, this Court recognized, "some form of minimum price-fixing agreement would be necessary in order to reap the benefits of predation." *Matsushita*, 475 U.S. at 595. This Court's observation applies *a fortiori* here because B&W had no assurance whatsoever that its competitors would not act contrary to its alleged predatory pricing scheme. As Liggett itself observes, "B&W knows that future prices depend upon the choices of fellow oligopolists." Pet. Br. at 29. But B&W's reliance on the *unknown* pricing decisions of others is particularly speculative where, as here, two of the alleged predator's competitors control about 70% of the market.

Liggett also notes—correctly in our view—that B&W would end up incurring *all* of the loss from the alleged predatory pricing, but could only "recoup" a small fraction of the hoped-for oligopoly profits. Pet. Br. at 28-29. Viewed in another light, for every dollar that B&W lost on its alleged predatory scheme, the industry would have

¹² As discussed further below, the record clearly contradicts Liggett's arguments. For example, the district court observed that, at that time, "[f]ive of the six major cigarette companies have significant entries in the [generic] category and growth has been steady. The growth of generic cigarettes has encouraged additional competition . . . on branded cigarettes." Pet. App. at 22a-23a. Today, even Marlboro, the industry's leading brand, has lost market share to generic cigarettes, as that segment continues its steady growth. See Shapiro, *Marlboro Smokers Defect to Discounters*, WALL ST. J. (Jan. 13, 1993), at B-1.

to earn approximately ten dollars in supracompetitive profits.¹³ This would make any such predation strategy even more unlikely.

Liggett concedes that action by any one of the other cigarette manufacturers would have been sufficient to defeat B&W's alleged expectations. Liggett also concedes that the generic segment was not subject to tacit collusion—let alone parallel behavior—by cigarette manufacturers. This highlights the key, and hazardous, deficiency in Liggett's argument—it lacks a limiting principle. Without regard to the facts of record, Liggett's theory can be applied to any company, no matter how small, in any industry that is allegedly moderately concentrated.

Liggett has simply proffered a theory in search of facts. Even if one accepts the novel prospect of oligopolistic price predation, the courts below found that there was no substantial record evidence supporting Liggett's recoupment theory. First, the district court specifically noted that the other competitors did not share B&W's motive:

Even before B & W began selling black and white cigarettes, RJR had entered the generic segment by repositioning Doral at generic prices. [Liggett] conceded that RJR had no anticompetitive intent and that Doral's entry expanded the generic segment. The evidence is uncontroverted that RJR's motive for selling generic cigarettes was to regain its number one position in the cigarette industry from Philip Morris. . . . Furthermore, there is no evidence that any of the other major cigarette companies had an interest in slowing the growth of generic cigarettes. Today, five of the six major manufacturers sell generic cigarettes in one form or another.

Pet. App. at 36a. Second, as to B&W's ability to raise prices after Liggett had allegedly been "disciplined"—the

¹³ This assumes that B&W would receive about 10%—its approximate market share in the market as a whole—of such excess profits.

imperative element of any recoupment theory—the district court found:

[I]n late 1985 B & W tried to raise the price of its generic cigarettes. Neither Liggett nor RJR followed with price increases—exactly what is supposed to happen when a company without market power unilaterally raises its price above competitive level. Had there been an alignment of interest, RJR would have followed B & W's lead.

Id. These findings alone should be sufficient to affirm the courts below.

Liggett attempts to lead this Court to believe that it has “successfully” passed through a number of “filters” that distinguish its claim from a baseless claim. Pet. Br. at 42. These filters are ultimately based on B&W's alleged successful prediction of its competitors' behavior. Even ignoring the fact that Liggett's assertions are inconsistent with the specific findings of the district court judge, GMA contends that such filters are inappropriate. Apart from inviting a rash of costly Robinson-Patman Act treble damage litigation by competitors in allegedly oligopolistic markets, Liggett would turn each such case into a jury trial about predictions of others' behavior. But competitors cannot compete in a vacuum. The First Circuit has noted, “[h]ow does one order a firm to set its prices *without regard* to the likely reactions of its competitors?” *Clamp-All Corp. v. Cast Iron Soil Pipe Inst.*, 851 F.2d 478, 484 (1st Cir. 1988), *cert. denied*, 488 U.S. 1077 (1989) (emphasis in original). Adoption of Liggett's theory would necessarily chill legitimate, pro-competitive behavior.

This Court should therefore reject Liggett's invitation to predicate liability on a new, untested, and highly speculative assessment of competitive injury. It is well-recognized that even an *express* price-fixing cartel is subject to a great deal of uncertainty—each member has economic incentives to cheat. F. Scherer and D. Ross, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE*,

238 (3d ed. 1990). Tacit collusion is even more fragile. In this connection, the district court below stated:

[A] leading antitrust authority has noted that the scenario for predatory pricing by a firm possessing a small share of the market is “highly speculative” and “presses the potential for tacit price coordination very far.” P. Areeda & H. Hovenkamp, *ANTITRUST LAW* 711.2c, at 538-39 (Supp. 1989).

Pet. App. at 34a. And the simple recognition by one competitor that it is engaged in “game theory,” Liggett's theory here, is more fragile still. In a market with six competitors, no single company, let alone one with less than a twelve percent market share, could have a “reasonable expectation” of recoupment in the absence of collusion. Yet Liggett's theory would permit liability based on such an unrealistic expectation and B&W's alleged ability—disproved by the record—to predict that its rivals would refrain from competing in the generic segment once Liggett had been “disciplined.”

This Court should specifically require more than the subjective analysis of competitors' future reactions in order to find that there was a “reasonable expectation” of recoupment where there is admittedly no shared purpose or parallel behavior, much less express or tacit collusion. The operative legal standard must distinguish attempts to price aggressively, but legitimately, from predatory pricing schemes. To avoid chilling vigorous price competition, the standard must provide guidance to businesses which may need to react flexibly, quickly, and frequently to competition. The standard should be objective and consistent with encouraging price competition. The standard must not penalize businesses for doing what we would expect of them—to unilaterally analyze their markets and price strategically to maximize profits. Liggett's proposed theory would allow none of this, but would instead encourage treble damage litigation under the Robinson-Patman Act.

CONCLUSION

This Court should reject Liggett's novel theory in this context. Liggett has conceded that there was no collusion on generic cigarettes; its theory was contradicted by the record and would permit improper inferences of irrational behavior. Adoption of Liggett's theory would therefore chill legitimate pricing competition and would be contrary to the purposes of the antitrust laws. It would create undue risks for firms in industries, like the grocery manufacturing industry, where Robinson-Patman Act suits already are commonplace, but where competition can take many forms—by introducing differentiated products, couponing, rebating, shelf payments, market “repositioning” of established products, etc.

Affirmation of the decision below would, in contrast, *not* penalize legitimate, strategic, competitive behavior. It would instead allow companies to react to multifaceted competition without the possibility of “retaliatory” treble damage litigation and permit consumers to enjoy the benefits of such competition.

Respectfully submitted,

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1992

LIGGETT GROUP, INC.,
now named Brooke Group Ltd.,
Petitioner,
v.

BROWN & WILLIAMSON TOBACCO CORPORATION,
Respondent.

On Writ of Certiorari to the
United States Court of Appeals
for the Fourth Circuit

BRIEF FOR THE BUSINESS ROUNDTABLE
AS AMICUS CURIAE
IN SUPPORT OF RESPONDENT

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IN THE
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now named Brooke Group Ltd.,
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**On Writ of Certiorari to the
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**BRIEF FOR THE BUSINESS ROUNDTABLE
AS AMICUS CURIAE
IN SUPPORT OF RESPONDENT**

INTEREST OF AMICUS CURIAE

The Business Roundtable is an association of about 200 member companies represented by their chief executive officers. The members are substantial companies engaged in a wide variety of businesses, and they face intense competition from domestic and foreign rivals. They therefore have a critical interest in the standards that are applied to judge the legality of aggressive competition in the marketplace.¹

Because both parties are represented by eminent counsel, and because it is likely that other briefs *amici* will be

¹ Pursuant to Rule 37.3 of the Rules of the Supreme Court, this brief is filed with the consent of both parties. Copies of the consent letters are filed herewith.

filed, The Business Roundtable will not burden this Court with arguments that merely restate those made elsewhere. It is also assumed that the basic facts will be set forth in the principal briefs. This brief will simply present the perspective of substantial companies that may be particularly vulnerable to claims of predation brought by competitors who are uncomfortable with vigorous competition.

SUMMARY OF ARGUMENT

This case is important because the Court's decision will have a substantial impact on the standards applied in predatory pricing claims under the Sherman Act, as well as discriminatory pricing claims under the Robinson-Patman Act. It is difficult to draw a line between predatory conduct, prohibited by law, and aggressive pricing competition, which the law encourages. There is serious risk that procompetitive conduct will be deterred if it is too easy for competitors who are uncomfortable with competition to assert predatory pricing claims.

One way to screen out inappropriate claims of predatory pricing is to demand proof that the immediate low prices, which hurt particular competitors, can reasonably be expected to result in higher prices, which hurt consumers. The plaintiff should be required to construct a plausible scenario of ultimate competitive harm. And that scenario should be judged by objective standards because an organization with multiple actors is likely to memorialize any number of hypothetical scenarios and to have conflicting expressions of intent.

The scenario of competitive harm in this case is the most strained and farfetched that has ever been asserted in litigation. Moreover, the postulated harm could never materialize without the active cooperation of the plaintiff. The unique character of the claims here does not diminish the concerns of the business community—it heightens them. If this plaintiff can reach a jury on the hypothetical scenario presented in this case, almost any

scenario will be adequate to support a claim. Aggressive price competition will inevitably be chilled.

Companies that contemplate aggressive, procompetitive action generally cannot take the time to pursue a full, internal inquiry into all the arguments that might someday be advanced in a lawsuit. They need to rely on the assumption that they can price aggressively if there is no reasonable likelihood that competition will be harmed.

ARGUMENT

I. THE IMPORTANCE OF THE CASE

Petitioner in this case asserts "primary line" injury under Section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a). The standards applied in this case, however, will also have an impact on predatory pricing claims under Section 2 of the Sherman Act, 15 U.S.C. § 2, because there is a growing tendency to recognize that the two statutes should be interpreted in a consistent way. See *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396, 1399, 1404 (7th Cir. 1989), *cert. denied*, 494 U.S. 1019 (1990); *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1042 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982). A leading treatise summarizes the congruity between the two statutes in this area as follows:

[B]oth statutes require the identification of an improper price and the distinction between unjustified and justified pricing. There is really only a single analytical process for doing so. This is not to claim an undisputed definition of improper pricing. But whatever one's definition of pro-competitive or anti-competitive pricing may be, it does not vary with the statutory words.

P. Areeda & H. Hovenkamp, *ANTITRUST LAW* ¶ 720'c (1992 Supp.). This case, therefore, is not just a narrow controversy under the Robinson-Patman Act; it can have

a sweeping effect on the law applied to unilateral business conduct.

II. THE FARFETCHED NATURE OF THE CLAIM

It is difficult to distinguish "unjustified" and "justified" pricing, but it is important to draw the line intelligently lest aggressive price competition be discouraged. Low prices, which may be challenged as discriminatory or predatory, confer an immediate and sure benefit on consumers. The claim that they may lead to higher prices, which could harm consumers down the road, involves speculation about the future. If this speculation is not based on rational inferences, consumers will suffer in the present based on unwarranted fears about the future.

The archetypal predatory pricing claim presents a relatively straightforward scenario. A dominant competitor cuts prices to drive all or most of its rivals out of business, thereby achieves some degree of monopoly power, and then exploits that power to recoup its losses by charging monopoly prices.

The scenario is easy to describe, but extraordinarily difficult to achieve. This Court has expressed a well-justified skepticism that even this relatively straightforward sequence is likely to play out in the real world. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

Now consider the scenario that Liggett proposes in support of its claim of competitive injury in this case. Brown & Williamson ("B&W") did not have a dominant position in the so-called "generic" cigarette business; Liggett did. B&W was a new entrant. Liggett does not claim that B&W was trying to drive Liggett out of the business; the claim rather is that the new entrant B&W could somehow intimidate the dominant competitor Liggett into yielding price leadership to B&W, so that B&W could drive all prices in the generic business to supra-competitive levels.

The scenario does not end here. Liggett further claims that B&W contemplated that these supra-competitive prices in the generic cigarette business would reduce price pressures on the branded segment of the business. B&W does not have a dominant position in the branded segment of the business either, but supposedly could rely on "oligopolistic" behavior by its rivals to raise prices to supra-competitive levels in that segment as well. See *Petition for a Writ of Certiorari* at 4-8.

This is an incredibly farfetched scenario for a number of reasons. First, it depends on the assumption that a new entrant into a business can intimate an existing near-monopolist, which also happens to have a deep pocket. Second, it depends on the assumption that the intimidated near-monopolist will eventually be induced to maintain supra-competitive prices. And, third, it depends on the assumption that collection of different rivals in another segment of the business will react to these supra-competitive prices by charging supra-competitive prices themselves. If any one of these assumptions fails, B&W's "investment" in the low prices complained of will be in vain.

Note also that if this complex scenario were to become real, Liggett would benefit as much as anyone else. Liggett is not a small competitor that has been squashed by predatory conduct; it continues to be a strong factor in its chosen segment of the business. Prices in the generic segment are either supra-competitive or they are not. If they are not, there has been no competitive harm; if they are, Liggett has been a principal, if not the principal beneficiary.

It is one thing to hold, as this Court has done,² that *in pari delicto* is no defense when the parties are unequal in bargaining power and the competitive harm has materialized. It is quite another thing to approve a theory,

² *Perma Life Mufflers, Inc. v. Int'l Parts Corp.*, 392 U.S. 134 (1968).

of incipient injury where the hypothetical harm can only result from the continued cooperation of an equally powerful complaining party. Cf. *Columbia Nitrogen Corp. v. Royster Co.*, 451 F.2d 3, 15-16 (4th Cir. 1971) ("when parties of substantially equal economic strength . . . bear equal responsibility for the consequent restraint of trade, each is barred from seeking treble damages from the other").

It could be argued that the unique, indeed bizarre, scenario of competitive harm advanced in this case means that a decision cannot have any general application and that the concerns of The Business Roundtable, and of other *amici*, are groundless. Quite the opposite is true. If the farfetched scenario advanced in this case can survive summary disposition, almost any scenario can. This means that companies with modest market positions, and no reasonable prospect of monopoly power, will still have to be concerned about claims of predation—even from competitors who are more powerful.

III. THE NEED FOR OBJECTIVE STANDARDS

The law is not concerned with low prices in themselves, but rather with the possibility of "later monopoly profits" ³ that may be the ultimate result. *Matsushita*, therefore, requires a plaintiff to demonstrate that there is a rational expectation that competitive harm will flow from the low prices complained of. Business enterprises need to be assured that they can safely price aggressively if there is no likely scenario of competitive harm.

A scenario does not become likely just because someone in a business enterprise has speculated about it. In large organizations like those who are members of The Business Roundtable there are many, many people who make proposals for action and purport to predict the future. This kind of speculation is encouraged, not discouraged, because the competition for ideas is important inside a busi-

³ *Matsushita*, 475 U.S. at 588-89.

ness, just as it is in the community at large. It is neither feasible nor practical to censor writings in advance, nor to seek out and destroy maverick internal communications, in order to ensure nothing remains that is inaccurate or of potential comfort to a future adversary.

For this reason, claims of competitive harm need to be evaluated by objective standards. The "intent" of a large organization is an artificial concept in any event, and competitive harm does not become plausible, within the meaning of *Matsushita*, just because someone in the organization says it is plausible.

Lower courts have come to recognize the "hazards of using evidence of desire to prevail competitively to forecast economic harm. '[E]ven in the presence of direct evidence of intent, we think a separate showing of predatory or anticompetitive conduct is necessary. Evidence of intent alone can be ambiguous or misleading.'" *Henry v. Chloride, Inc.*, 809 F.2d 1334, 1344 (8th Cir. 1987) (citing *Conoco, Inc. v. Inman Oil Co.*, 774 F.2d 895, 904 n.6 (8th Cir. 1985)). See also *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227 (1st Cir. 1983); *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340 (3rd Cir. 1981).

IV. PRACTICAL CONSIDERATIONS

Rules of decision in antitrust cases have to be *practical*. They must be capable of application in manageable trials,⁴ and they also must be capable of reasonable application by business people in the heat of competitive battle. There are costs and burdens associated with internal law compliance, as well as costs and burdens associated with external law enforcement. Sound rules of *per se* illegality are practical in both arenas: they not only facilitate the trial of cases, but also help business people to make decisions. It is relatively easy, for example, to advise that price-fixing is illegal—regardless of whether the prices are reasonable. But it is equally important to know that

⁴ Cf. *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

some things are *per se* legal or nearly so. Otherwise, business decisions can be stalled indefinitely.

Competitive pricing is the "central nervous system" of a free-market economy, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940), and fast responses are imperative. It is not practical for a competitive business that needs to make price decisions quickly in the marketplace to delay until it has undertaken a full-fledged economic inquiry or a sweep of company files for damaging material. Competitive businesses need to act on the basis of roughcut rules of decision.

This is the reason why objective, cost-based standards are important for determining whether prices are "predatory" in the first place. "It cannot be the purpose of the antitrust laws to force efficient firms to hold a 'price umbrella' over their less efficient or less aggressive rivals." P. Areeda & H. Hovenkamp, *ANTITRUST LAW* ¶¶ 710-21, 714.1b (1992 Supp.)⁵ And it also is the reason why it is important to demand, as *Matsushita* does, that there be some plausible scenario to explain how even "predatory" prices are likely to cause competitive harm. As this Court said in *Matsushita*, "[w]e must be concerned lest a rule or precedent that authorizes a search for a particular type of undesirable pricing be-

⁵ A majority of circuits have adopted an objective, cost-based standard that provides businesses with a safe harbor of sorts—the "Areeda-Turner" test. This test presumes that prices above short-run marginal cost cannot be predatory. See, e.g., *Irvin Indus., Inc. v. Goodyear Aerospace Corp.*, 974 F.2d 241 (2nd Cir. 1992); *Henry v. Chloride, Inc.*, 809 F.2d 1334 (8th Cir. 1987); *Adjusters Replace-A-Car, Inc. v. Agency Rent-A-Car, Inc.*, 735 F.2d 884 (5th Cir. 1984), *cert. denied*, 469 U.S. 1160 (1985); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227 (1st Cir. 1983); *MCI Communications Corp. v. Am. Tel. & Tel. Co.*, 708 F.2d 1081 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983). Nonetheless, other circuits have applied different standards. See, e.g., *McGahee v. N. Propane Gas Co.*, 858 F.2d 1487 (11th Cir. 1988), *cert. denied*, 490 U.S. 1084 (1989).

havior end up by discouraging legitimate price competition." 475 U.S. at 594.

There is nothing more discouraging than the thought of an antitrust lawsuit—particularly one that cannot be resolved summarily. The Court might consider the message that the larger business community will receive if this case holds that a company risks an antitrust trial because of an aggressive attack on a near-monopolist in its own backyard, when there is no potential for competitive harm absent the active cooperation of the near-monopolist itself. If this case presents jury issues, there are myriad less fanciful hypotheticals that competitors could employ to discourage price competition.

In addition, for predatory pricing to make sense, there must be substantial evidence that the alleged predator can recoup its losses at some future point. As this Court wrote in *Matsushita*, "[t]he success of any predatory scheme depends on *maintaining* monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain." 475 U.S. at 589 (emphasis in original). In most cases, this can occur only if the monopoly prices do not attract new entry; "without barriers to entry it would presumably be impossible to maintain supracompetitive prices for an extended time." *Matsushita*, 475 U.S. at 591 n.15. Accord, e.g., *A. A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396 (7th Cir. 1989), *cert. denied*, 494 U.S. 1019 (1990). The Court should confirm that a dangerous probability that losses can be recouped is essential for liability.

In this case, B&W simply could not have rationally expected to recoup its losses. As a brand new entrant into the generic business, it could not assume that the dominant company, Liggett, could be induced to charge supra-competitive prices. And even if Liggett did, B&W—with a mere 12% of the relevant market for branded cigarettes—could not be sure that its larger competitors would also charge supra-competitive prices.

In fact, the farfetched scenario that Liggett postulates did not materialize. What actually happened was that B&W's competitors easily expanded their product lines to include generic cigarettes and the market for generics grew from 2.8 billion cigarettes in 1981 to nearly 80 billion in 1989.

CONCLUSION

Petitioners have urged that there are special facts which would justify a reversal in this case, and that reliance on these facts would help to contain the impact of such a decision. The Business Roundtable has not scrutinized the full record and therefore cannot express any views on disputed issues of fact. Moreover, neither party is a member, and The Business Roundtable has no special interest in the individual fortunes of either company.

The Business Roundtable is, however, vitally interested in the legal principles that will be established in this case. It is very difficult for this Court to issue an opinion that does not have an effect far beyond the case at hand. Despite the most careful language of limitation in an opinion business counselors are bound to attach significance to the decision in this case—as indeed they already attach significance, rightly or wrongly, to the fact that it has been accepted for review. There is a real risk that aggressive price competition in a large segment of the business world will be chilled if this Court's decision broadly expands the universe of companies that have to be concerned about claims of predation.

The Business Roundtable urges the Court to reaffirm the principles set forth in *Matsushita* and to emphasize once again that an antitrust plaintiff must present a plausible scenario of competitive harm in order to sustain a predatory pricing claim.

Respectfully submitted,

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

LIGGETT GROUP INC.,
now named Brooke Group Ltd.,
v. *Petitioner,*

BROWN & WILLIAMSON TOBACCO CORPORATION,
Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fourth Circuit

**BRIEF OF ATLANTIC RICHFIELD COMPANY
AS AMICUS CURIAE IN SUPPORT OF RESPONDENT**

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1992

No. 92-466

LIGGETT GROUP INC.,
now named Brooke Group Ltd.,
v. *Petitioner,*

BROWN & WILLIAMSON TOBACCO CORPORATION,
Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fourth Circuit

**BRIEF OF ATLANTIC RICHFIELD COMPANY
AS AMICUS CURIAE IN SUPPORT OF RESPONDENT**

Atlantic Richfield Company ("ARCO"), as *amicus curiae*, respectfully urges that the Court affirm the decision below, *Liggett Group, Inc. v. Brown & Williamson Tobacco Corp.*, 964 F.2d 335 (4th Cir.), *cert. granted*, 113 S. Ct. 490 (1992).¹

INTEREST OF THE AMICUS CURIAE

ARCO is an integrated oil company that, among other things, refines and markets gasoline throughout the Western United States. ARCO markets gasoline directly through its own gasoline stations and indirectly through independent ARCO-branded distributors and dealers.

¹ Pursuant to Rule 37.3 of this Court, letters showing that counsel for both parties have consented to the filing of this brief are being filed with the Clerk herewith.

In 1982, ARCO instituted a cost-cutting campaign that enabled it to become more competitive through lower gasoline prices to the consumer. The campaign was successful in the market. ARCO and its dealers sold more gasoline. Consumers paid less at the pump. Only ARCO's competitors complained.

One of those competitors, USA Petroleum Company ("USA Petroleum"), filed an antitrust action challenging ARCO's low prices under a number of federal and state statutes. Almost ten years later, that lawsuit is still pending even after this Court held that USA Petroleum on summary judgment had "failed to demonstrate that it has suffered any antitrust injury." *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 346 (1990). Incredibly, on remand from this Court, the Ninth Circuit Court of Appeals sent the case back to the district court to permit USA Petroleum to pursue its antitrust claims against ARCO. *USA Petroleum Co. v. Atlantic Richfield Co.*, 972 F.2d 1070 (9th Cir. 1992).

ARCO's predicament underscores the need for a clear and easily applied standard to screen out baseless antitrust challenges by a competitor plaintiff to a firm's price-cutting practices. This is just such a case and provides the Court with an opportunity to announce such a standard. ARCO, both as a competitor and a litigant, has a vital interest in the issues presented here.

ARCO's Low-Price Marketing Program

ARCO began its low-price marketing program in order to compete more effectively. ARCO discontinued its costly credit card program and otherwise lowered its costs of refining and selling gasoline. These measures enabled ARCO to lower the wholesale prices it charged to dealers. ARCO encouraged the dealers to pass these decreases along to consumers in the form of lower pump prices.

By becoming a low-price marketer, ARCO sought to appeal to gasoline consumers who had become more price-conscious after the dramatic price increases of the 1970's. Prior to ARCO's move, price-conscious consumers were mostly attracted to independent marketers such as USA Petroleum, which had traditionally sold gasoline with fewer services and no credit, but at prices lower than those charged by major-brand retail outlets.

ARCO's program was highly successful. ARCO's share of the relevant market (California and Washington) increased from 10-12% in 1981 to roughly 14-16% in 1982. ARCO's low prices were a boon to consumers since the benefit conferred by the low prices was never offset by future monopoly prices.

USA Petroleum's Lawsuit

As a direct result of ARCO's program, USA Petroleum filed suit, claiming that it had lost sales and profits due to ARCO's low prices. USA Petroleum's complaint alleged, among other claims, predatory pricing in violation of § 2 of the Sherman Act, a price-cutting conspiracy between ARCO and its dealers in violation of § 1 of the Sherman Act, and primary-line price discrimination in violation of the Robinson-Patman Act. After years of discovery and other proceedings, costing ARCO millions of dollars, ARCO moved for summary judgment on USA Petroleum's Sherman Act § 2 predatory pricing claim based upon an undisputed record showing that ARCO's market share was far too small to pose any threat of monopolization. In response, USA Petroleum voluntarily dismissed the Sherman Act § 2 claim, conceding that it could not prove predatory pricing. ARCO then moved for summary judgment on USA's Sherman Act § 1 claim on the ground that USA Petroleum, as a competitor of ARCO, had not suffered antitrust injury from the alleged conspiracy to fix low, but now concededly non-predatory, prices.

The district court granted ARCO summary judgment. But, the Ninth Circuit reversed. *USA Petroleum Co. v. Atlantic Richfield Co.*, 859 F.2d 689 (9th Cir. 1989). This Court then reversed the Ninth Circuit, holding that USA Petroleum "has failed to meet the antitrust injury test in this case." 495 U.S. at 335. This Court agreed with ARCO that USA Petroleum could not complain of losses from increased competition.

On remand, the Ninth Circuit effectively reversed this Court and refused to issue an order affirming the district court's grant of summary judgment. The same two judges who had originally reversed the district court ruled on remand that USA Petroleum still was entitled to try to establish antitrust injury by proving predatory pricing, which they suggested could be proven solely by showing "pricing below cost," without any need to prove market power or the likelihood of recoupment. 972 F.2d at 1075-76. In so ruling, these judges ignored this Court's holding unequivocally disposing of USA's Sherman Act § 1 claim on antitrust injury grounds, and further ignored this Court's holding that antitrust injury flowing from a competitor's low prices can be established only by proving predatory pricing "under § 2 of the Sherman Act." 495 U.S. at 339. The third judge dissented, stating that his "oath of office require[d] [him] to follow the mandate of the Supreme Court." 972 F.2d at 1077.

ARCO filed a petition for rehearing and suggestion for rehearing *en banc*. This petition is still pending almost six months later. If the Ninth Circuit does not grant rehearing, ARCO will be compelled to return to this Court for a writ directing the Ninth Circuit to follow this Court's mandate.

The Impact On ARCO Of This Court's Decision In This Case

ARCO has a vital interest in the antitrust issues presented in this case. Petitioner cited the Ninth Circuit's

decision on remand in *ARCO* as one of the circuit court opinions in conflict with the Fourth Circuit's decision in this case. Petition For Writ Of Certiorari ("Petition") 20-21 & n.27. This Court's affirmance of the Fourth Circuit will send a clear signal to the Ninth Circuit that its decision on remand in the *ARCO* case not only disregards this Court's mandate, but is completely out of step with this Court's other recent decisions on price cutting. Such a signal should bring about the end of USA Petroleum's antitrust case without further ado.

More importantly, the termination of USA Petroleum's lawsuit, however belatedly, and the announcement in this case of a rule precluding antitrust claims based upon price cutting where predation is impossible, will dispel the chilling effect such claims have on price cutting. Not only respondent and ARCO, but also consumers, who enjoy the benefits of low prices, and the courts, which will not be burdened with baseless claims, will be the beneficiaries of such a ruling.

SUMMARY OF ARGUMENT

In a line of cases from *Brunswick*² to *ARCO*,³ which includes *Cargill*⁴ and *Matsushita*,⁵ this Court has rejected every attempt by a competitor plaintiff to impose antitrust liability based upon price cutting that did not threaten to create a monopoly. This is just such a case. Nonetheless, petitioner proceeds as though these opinions do not control its Robinson-Patman Act claim. Petitioner

² *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977) ("*Brunswick*").

³ *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990) ("*ARCO*").

⁴ *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104 (1986) ("*Cargill*").

⁵ *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986) ("*Matsushita*").

suggests that such claims are uniquely exempt from limitations applicable to all of the other antitrust laws when the challenged conduct is price cutting. However, neither the language of, nor the policy underlying, the Robinson-Patman Act supports petitioner's position. Rather, *Matsushita*, *Cargill* and *ARCO* support affirmance of the Fourth Circuit's ruling rejecting petitioner's primary-line Robinson-Patman Act claim based on predatory pricing where respondent's 12% market share does not present any danger of monopoly.

Petitioner argues that applying a dangerous probability of monopoly standard to its claim would impermissibly coalesce the Robinson-Patman Act and the Sherman Act. Petitioner further argues that the language of the Robinson-Patman Act and existing case law preclude such a coalescence. But, petitioner's argument ignores the Court's holdings (in *ARCO* and *Cargill*, respectively) that competitor plaintiffs suing under Sherman Act § 1 and Clayton Act § 7 also must establish predatory pricing under Sherman Act § 2. Moreover, both the language of the Robinson-Patman Act and the cases interpreting it confirm that the Act should be construed, like the other antitrust laws, to avoid burdening competition that benefits consumers. The Act expressly refers to pricing conduct that injures *competition*, not *competitors*. Faithful to that language, the circuit courts have applied Sherman Act § 2 liability standards to primary-line Robinson-Patman Act claims.

Antitrust policy supports consistent application across all antitrust laws of the rule requiring rejection of claims by competitors challenging low prices that pose no threat of monopoly. Consumers, whose welfare is the primary concern of the antitrust laws, benefit from such low prices. Courts should protect consumers' interest by guarding against antitrust claims that could chill price-cutting activity. Petitioner's indefinite, difficult-to-apply and over-broad definition of predatory pricing, even if limited

to Robinson-Patman Act claims, will discourage vigorous price competition, encourage suits challenging legitimate price cutting, and make such suits more difficult to dispose of at an early stage of litigation. Accordingly, the Court should apply to such claims the same "dangerous probability" requirement it uses in price-cutting claims under the other antitrust laws.

ARGUMENT

PETITIONER'S ROBINSON-PATMAN ACT CLAIM DOES NOT JUSTIFY A DEPARTURE FROM THIS COURT'S RECENT DECISIONS CONSISTENTLY REJECTING COMPETITOR LAWSUITS ATTACKING LOW PRICES THAT DO NOT THREATEN RECOUPMENT THROUGH FUTURE MONOPOLY

A. The Court Consistently Has Rejected Antitrust Claims By Firms Challenging Their Competitor's Low Prices That Posed No Threat Of Monopoly

In four cases in which the plaintiff was a competitor complaining of the defendant's low prices (actual or threatened), the Court formulated and applied the antitrust-injury requirement in order to screen out claims that, while arguably encompassed within the language of the substantive antitrust laws, were inimical to antitrust policy. See notes 2-5 *supra*. "Antitrust injury" performs this screening function by obligating an antitrust plaintiff to prove that he has been injured by "an *anti-competitive* aspect of the defendant's conduct." *ARCO*, 495 U.S. at 340-41 (emphasis in original). The antitrust-injury requirement thus ensures

"that the harm claimed by plaintiff corresponds to the rationale for finding a violation of the antitrust laws in the first place, and it prevents losses that

stem from competition from supporting suits by private plaintiffs for either damages or equitable relief."

ARCO, 495 U.S. at 342 (emphasis added).⁶

Of greatest significance here, the Court in *ARCO* held that "in the context of pricing practices, only predatory pricing has the requisite anti-competitive effect [for antitrust injury]." 495 U.S. at 339. Low, but non-predatory, prices cannot give rise to antitrust injury because "[l]ow prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition" *Id.* at 340.

ARCO did not make new law in this regard. Rather, it simply followed the holding in *Cargill*, 479 U.S. at 116-19, that a plaintiff complaining of competition from a rival's low but non-predatory prices cannot establish antitrust injury. In *Cargill*, the Court found that a competitor plaintiff could not challenge a merger presumed to be illegal under § 7 of the Clayton Act on the ground that it would be forced to compete against the merged company's low prices. Low, but non-predatory, prices could only enhance rather than threaten competition, and therefore could not inflict antitrust injury:

"To hold that the antitrust laws protect competitors from the loss of profits due to [non-predatory] price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share."

479 U.S. at 116. Even earlier, in *Matsushita*, the Court held that the only conspiracy that could "have caused [plaintiffs that were competitors of defendants] to suffer an 'antitrust injury'" was a "conspiracy to monopolize the American market through predatory pricing. . . ." 475 U.S. at 586.

⁶ See Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 35 (1984) (The antitrust-injury doctrine "responds to the fact that often the lure of damages (or the ability to raise rivals' costs) induces plaintiff to challenge conduct that is procompetitive").

As this language from *Matsushita* suggests, predatory pricing and monopolization (actual or attempted) go hand in hand.⁷ Other language in *Matsushita* makes even more clear that predatory pricing occurs only where the low prices can enable a dominant firm to eliminate its rivals and then charge monopoly prices:

"[T]he conspirators must have a reasonable expectation of recovering, in the form of later monopoly profits, more than the losses suffered. . . . Moreover, it is not enough simply to achieve monopoly power, as monopoly pricing may breed entry by new competitors eager to share in the excess profits. The success of any predatory scheme depends on maintaining monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain."

475 U.S. at 589 (emphasis (except for the Court's emphasis on "maintaining") added).

Similarly, the Court in *Cargill* also noted that only a firm with a market share large enough to threaten monopoly could engage in predatory pricing. Indeed, the Court dismissed the possibility that a firm with a 21% market share could engage in predatory pricing. 479 U.S. at 119 n.15. The Court stated that such a firm

"would harm only itself by embarking on a sustained campaign of predatory pricing. Courts should not find allegations of predatory pricing credible when the alleged predator is incapable of successfully pursuing a predatory scheme."

Id. Quoting *Matsushita*, the Court further noted that successful predatory pricing depends on "maintaining monopoly power for long enough both to recoup the preda-

⁷ See Page & Blair, *Controlling the Competitor Plaintiff in Antitrust Litigation*, 91 Mich. L. Rev. 111, 119 n.48 (1992) ("Although dangerous probability is indeed a § 2 requirement, in a broader sense it is inseparable from any coherent definition of predatory pricing").

tor's losses and to harvest some additional gain." *Cargill*, 479 U.S. at 121 n.17 (emphasis added).

Most recently, the Court in *ARCO* reaffirmed that the predatory pricing that is required for antitrust injury in a suit by a competitor challenging low prices exists only in the context of threatened or actual monopolization. The plaintiff in *ARCO* argued that it would be improper to require it to prove the Sherman Act § 2 element of dangerous probability of monopolization in order to bring its claim for violation of Sherman Act § 1 based upon an alleged price-cutting conspiracy between *ARCO* and its dealers. The Court expressly rejected plaintiff's argument:

"Respondent further argues that it is inappropriate to require a showing of predatory pricing before antitrust injury can be established when the asserted antitrust violation is an agreement in restraint of trade under § 1 of the Sherman Act, rather than an attempt to monopolize prohibited by § 2. Respondent notes that the two sections of the Act are quite different. . . . In sum, *respondent maintains that it has suffered antitrust injury even if petitioner's pricing was not predatory under § 2 of the Sherman Act.*

We reject respondent's argument."

495 U.S. at 338-39 (emphasis added).

B. The Predatory Pricing Principles Announced In The Court's Antitrust-Injury Opinions Apply To Petitioner's Primary-Line Robinson-Patman Act Claim

The principle that a firm can establish antitrust injury from its competitor's pricing practices only by proving predatory pricing under § 2 of the Sherman Act applies to all antitrust actions. The Court in *ARCO* explicitly so held. 495 U.S. at 340 ("We have adhered to this principle regardless of the type of antitrust claim involved"). The Court rejected the argument that a doctrine developed (in *Brunswick* and *Cargill*) in the context of a Clayton Act § 7 violation was inapplicable to the Sherman Act § 1 violation alleged in *ARCO*. The *ARCO* Court explained:

"To be sure, the source of the price competition in the instant case was an agreement allegedly unlawful under § 1 of the Sherman Act rather than a merger in violation of § 7 of the Clayton Act. *But that difference is not salient.*"

495 U.S. at 340 (emphasis added).

This holding disposes of any argument that a difference between the Sherman Act and the Robinson-Patman Act is salient for these purposes. Thus, the relevant language of the Robinson-Patman Act and Clayton Act § 7 is identical. Both prohibit conduct (the former prohibits price discrimination, and the latter prohibits mergers) that "may . . . substantially . . . lessen competition or tend to create a monopoly" 15 U.S.C. §§ 13(a), 18. Accordingly, the same antitrust-injury principles should apply whether the source of the price competition is a discriminatorily low price in violation of the Robinson-Patman Act or a merger illegal under the Clayton Act. The antitrust-injury test therefore requires the plaintiff in a primary-line price discrimination claim to prove predatory pricing under Sherman Act § 2 standards. Petitioner's inability to satisfy this standard should be fatal to its claim.

Moreover, the Court should apply the same standard to determine the issue presented by the Petition—whether an injury to competition, necessary for a primary-line Robinson-Patman Act violation, has occurred. Applying one injury-to-competition standard to determine if a violation had occurred and a different such standard to determine the standing of the natural private plaintiff in such a case—a competitor of the discriminating seller—would be incongruous. Both parties here advocate avoiding such an incongruity. Petitioner's Reply Brief In Support Of Petition For Writ Of Certiorari (at 5-6 n.10), argues for identical standards for determining a competitor-plaintiff's antitrust injury and the injury-to-competition element.

Of course, petitioner argues that both can be satisfied without proving predatory pricing in violation of Sherman Act § 2. Petitioner argues that the Robinson-Patman Act's prohibition of price discrimination that "may . . . substantially . . . lessen competition or tend to create a monopoly" (15 U.S.C. § 13(a)) indicates an intent to reach conduct that does not threaten a monopoly. Brief For The Petitioner 24-27. But, petitioner's argument ignores the antitrust-injury opinions discussed above and, as discussed below, is not compelled by either the language of the Robinson-Patman Act or the cases interpreting the Act.

The Act expressly refers to price discrimination that lessens *competition*. It does not prohibit discrimination that injures a *competitor*.⁸ The Act is in accord with the fundamental principle that "[t]he antitrust laws were enacted for 'the protection of *competition*, not *competitors*.'" *ARCO*, 495 U.S. at 338 (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962) (emphasis in original)).⁹ The Act therefore provides no reason to depart from this Court's statements that prices that are low, but not predatory under Sherman Act § 2, do not injure competition. *ARCO*, 495 U.S. at 339-40; see *supra* at 8-10.

The relevant case law is in accord. Several circuit courts have held that the standard for imposing primary-

⁸ See P. Areeda and H. Hovenkamp, *Antitrust Law* ¶ 720d (Supp. 1992) (this language "does refer to competition rather than competitors. Thus, some actual or prospective market impact is contemplated. The phrase 'may be' may indicate something less than a threat of imminent monopolization, but it remains hard to see how even below-cost pricing by a small firm in a market without entry barriers could satisfy this statute").

⁹ See *United States v. United States Gypsum Co.*, 438 U.S. 422, 458 (1978) ("the Robinson-Patman Act should be construed so as to insure its coherence with 'the broader antitrust policies that have been laid down by Congress'").

line liability under the Robinson-Patman Act should be the same as that under § 2 of the Sherman Act. See, e.g., *Henry v. Chloride, Inc.*, 809 F.2d 1334, 1345 (8th Cir. 1987); *D. E. Rogers Associates, Inc. v. Gardner-Denver Co.*, 718 F.2d 1431, 1439-40 (6th Cir. 1983), *cert. denied*, 467 U.S. 1242 (1984). Professor Areeda describes these and other opinions as follows:

"In a very significant development, several courts have accepted the main text argument that primary-line injury under the Robinson-Patman Act implicates the same kinds of concerns as predatory pricing under Sherman Act § 2."

P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 720c (Supp. 1992). Professor Areeda further notes that

"the key point is that both statutes require the identification of an improper price and the distinction between unjustified and justified pricing. There is really only a single analytical process for doing so. . . . whatever one's definition of pro-competitive or anti-competitive pricing may be, it does not vary with the statutory words."

Id.; see also Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697, 727 (1975) (noting that "[t]he basic substantive issues raised by the [Robinson-Patman] Act's concern with primary-line injury to competition and by the Sherman Act's concern with predatory pricing are identical").

Petitioner argues that applying Sherman Act standards in a Robinson-Patman Act case would "invite a complete coalescence" of the two statutes. Petition 21-22; Brief For The Petitioner 24. Once again, petitioner ignores the ground already plowed in this Court's antitrust injury opinions. In *Cargill*, the Court applied the Sherman Act concept of predatory pricing even though the substantive antitrust provision involved in that case—Clayton Act § 7—makes illegal mergers that might not be

illegal under the Sherman Act. *See supra* at 8. Nonetheless, as the dissent in *Cargill* noted (479 U.S. at 123 & n.1), the majority's requirement that the competitor plaintiff prove predatory pricing effectively required the competitor-plaintiff in a § 7 case to "establish a violation of the Sherman Act."

In *ARCO*, the Court again required the plaintiff to prove predatory pricing under Sherman Act § 2 where the plaintiff asserted a violation of a different antitrust law—there Sherman Act § 1. The plaintiff in *ARCO* had argued that this would impermissibly engraft a § 2 standard on a § 1 claim. The *ARCO* plaintiff's argument is virtually identical to petitioner's argument that the Fourth Circuit opinion in this case improperly "coalesces" the Sherman Act with the Robinson-Patman Act. The Court rejected plaintiff's argument in *ARCO*, and there are no statutory or case-law reasons not to reject petitioner's argument here. Moreover, as demonstrated below, the same antitrust policies that underlie *Matsushita*, *Cargill* and *ARCO* support rejection of the argument.

C. Antitrust Policy Supports Rejection Of Competitor Lawsuits, Brought Under Any Antitrust Law, Where The Complaint Is Low Prices But The Defendant's Market Share Is Too Small To Present Any Real Danger Of Monopoly Power

1. Low prices benefit consumers, whose welfare is the primary concern of the antitrust laws

The consumer interest in competition is the touchstone of antitrust policy. It would be "inimical to the purposes of" the antitrust laws to award damages for losses from increased competition, because "[t]he antitrust laws . . . were enacted for 'the protection of competition, not competitors.'" *Brunswick*, 429 U.S. at 488 (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962) (emphasis in original)).

Low prices are both the means of competition and the fruit of the competitive process. "[C]utting prices in

order to increase business often is the very essence of competition." *Matsushita*, 475 U.S. at 594; *see Cargill*, 479 U.S. at 121 n.17 ("lowering prices . . . stimulates competition . . ."); *ARCO*, 495 U.S. at 340 ("Low prices benefit consumers regardless of how those prices are set . . ."); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 724 (1988) (interbrand competition leads to lower prices to consumers and for that reason is "the primary concern of antitrust law"). The possibility that these low prices may deprive rivals of profits is of no concern under the antitrust laws. *See ARCO*, 495 U.S. at 337 n.7 ("a firm cannot claim antitrust injury from non-predatory price competition on the asserted ground that it is 'ruinous'. [citations omitted] '[T]he statutory policy precludes inquiry into the question whether competition is good or bad'"); *Spectrum Sports, Inc. v. McQuillan*, 61 U.S.L.W. 4123, 4127 (U.S. Jan. 25, 1993) ("The purpose of the [Sherman] Act is not to protect businesses from the working of the market. . .").

Low prices can threaten the consumer interest in competition in only one instance: when the firm charging the low prices is in a position to use those prices to eliminate its rivals and then recoup the benefits bestowed by the low prices by charging monopoly prices. *See supra* at 8-10.¹⁰

¹⁰ The Seventh Circuit, in *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396, 1401 (7th Cir. 1989), *cert. denied*, 494 U.S. 1019 (1990), recognized that without the possibility of future monopoly prices, low prices can only benefit consumers and thus cannot be predatory:

"Predatory prices are an investment in a future monopoly, a sacrifice of today's profits for tomorrow's. The investment must be recouped. If a monopoly price later is impossible, then the sequence is unprofitable and we may infer that the low price now is not predatory. More importantly, if there can be no 'later' in which recoupment could occur, then the consumer is an unambiguous beneficiary even if the current price is less than the cost of production. Price less than cost today, followed by the competitive price tomorrow, bestows a gift on consumers. Because antitrust laws are designed for

The Fourth Circuit here concluded that where respondent "controlled only 12% of the relevant market" its prices "could not be found to be predatory because they did not provide an economically rational basis 'to recoup . . . losses and harvest some additional gain.'" 964 F.2d at 342. Petitioner attacks that conclusion, but its attack gives insufficient weight to the policies in favor of beneficial price cutting and the potential deterrent effect thereon of the rule its champions.

2. In order not to deter pro-competitive price cutting, a clear and easily applied rule is needed to determine when future monopoly pricing is threatened

Rules that create legal risks for price cutters should be avoided. Such rules "chill the very conduct the anti-trust laws are designed to protect." *Matsushita*, 475 U.S. at 594; see *Sharp, supra*, 485 U.S. at 728 (warning against rules that cause "[m]anufacturers to forgo legitimate and competitively useful conduct rather than risk treble damages and perhaps even criminal penalties").

A rule lacking clear standards for a firm to forecast when price cutting will be deemed illegal inevitably will create these risks and frustrate the goals of antitrust. A firm that is unsure whether its price cutting will be deemed illegal has a strong incentive not to cut prices at all. The First Circuit in *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983) (quoted in part in *Matsushita*, 475 U.S. at 594), expressed this point succinctly:

"Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve. . . . we must be concerned lest a rule or precedent that

the benefit of consumers, not competitors, . . . a gift of this kind is not actionable."

881 F.2d at 1401 (citations omitted).

authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition."

See Baumol & Ordover, *Use of Antitrust To Subvert Competition*, 28 J. L. & Econ. 247, 254 (1985) ("[t]he potential defendant who cannot judge in advance with any reasonable degree of certainty whether its behavior will afterward be deemed illegal is particularly vulnerable to guerilla warfare and intimidated into the sort of gentlemanly competitive behavior that is the antithesis of true competition").

An indefinite or unclear rule also will provide a similar lack of guidance to courts. It therefore will significantly decrease the possibility of disposing of an antitrust lawsuit on summary judgment. The prospect of being forced to defend a lawsuit through trial, no matter how meritorious the defense, necessarily will encourage firms to avoid price-cutting activities that could expose them to litigation. See Snyder & Kauper, *Misuse of the Antitrust Laws: The Competitor Plaintiff*, 90 Mich. L. Rev. 551, 552, 588 (1991) (advocating bright line tests such as market-share screens to dispose of antitrust claims at the summary judgment stage: "[u]nless courts are able effectively to confine suits by competitor plaintiffs to those that are truly meritorious, and to do so relatively early in the litigation process, such suits may have significant anticompetitive consequences").¹¹ More-

¹¹ Professor Areeda agrees that market-share tests are appropriate screens for analyzing predatory pricing:

"[I]t will sometimes be obvious at an early stage of discovery that there is no relevant market in which predation could create a dangerous probability of monopoly and thus in which predation has probably occurred. Dismissal of claims is presumptively appropriate whenever it appears that the defendant is not already dominant within a concentrated market or that entry barriers are too low to allow a hypothetical predator who has ruined rivals to maintain monopoly prices

over, the inability of firms to dispose quickly of meritless claims, combined with the consequent real possibility of a large treble-damage award, creates a strong incentive to settle such claims regardless of their lack of merit, further discouraging beneficial price cutting.

An indefinite or unclear price-cutting rule has the added disadvantage of encouraging competitor lawsuits challenging legitimate price cutting. Baumol & Ordover, *supra*, at 265 ("vagueness in the standards of unacceptable behavior plays into the hands of those who would use the antitrust laws as anticompetitive weapons"). Firms that are hurt by competition already have a natural incentive to use the antitrust laws to hinder pro-competitive behavior. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 34 (1984) ("[a]ntitrust litigation is attractive as a method of raising rival's costs . . ."); Baumol & Ordover, *supra*, at 252 ("[a]ntitrust, whose objective is the preservation of competition, by its very nature lends itself to use as a means to undermine effective competition. This . . . is very dangerous for the workings of our economy"). The vague and indefinite rule sought by petitioner would increase this incentive.

ARCO's experience in defending the lawsuit brought against it by USA Petroleum illustrates the need for clear and easily applied screens to filter out baseless challenges to price-cutting conduct. ARCO has spent almost 10 years and millions of dollars defending itself against an antitrust lawsuit that was initiated in re-

without causing reentry or new entry that would restore competitive prices."

P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 711.2b (Supp. 1992). According to Professor Areeda, most commentators agree that "predatory pricing is a plausible strategy only for a firm that begins with a very substantial market share." *Id.* at ¶ 711.2c. Professor Areeda further notes that "it seems reasonable to presume that a market share below 60 percent is too small to make predation likely." *Id.*

sponse to ARCO's decision to eliminate its credit card and implement other price-reducing measures. ARCO's price cutting benefited consumers, and because ARCO never had more than a 17% market share during any relevant period, those gains to consumers never were, and never could have been, offset by later monopoly prices. Accordingly, ARCO's price cutting was undeniably pro-competitive. Nonetheless, ARCO's conduct has caused it, paradoxically, to be entangled in an antitrust lawsuit that has not yet ended. A rule barring competitors from using any of the antitrust laws to challenge a rival's price cutting when that rival poses no threat of monopoly would have ended USA Petroleum's suit early or caused it not to sue in the first place. A rule to the contrary will deter beneficial price cutting in gasoline and other product markets.

3. Only the "dangerous probability" test provides the necessary clear-cut standard.

For all of the foregoing reasons, a clear-cut standard for determining when firms may legally engage in price-cutting activity is necessary. The dangerous probability of monopolization requirement satisfies this need by providing a market-based filter to weed out baseless claims of illegal price cutting at an early stage of litigation. The Court has applied this standard to claims involving predatory conduct under Sherman Act § 2. Through the vehicle of antitrust injury, it also has applied this standard to Sherman Act § 1 claims brought by competitors in *ARCO*, and has suggested its application to Clayton Act § 7 claims brought by competitors in *Cargill*. Because price cutting has the same competitive effect regardless of the statute under which it is challenged, the Court should apply the same standard to the price cutting challenged under § 2(a) of the Robinson-Patman Act in this case.

4. Petitioner's proposed standard will discourage, rather than encourage, legitimate price competition

The rule proposed by petitioner for primary-line Robinson-Patman Act liability does not provide the necessary clear-cut standard. In fact, as demonstrated below, it offers only uncertainty and ambiguity. If adopted, petitioner's proposed rule will encourage claims that deter beneficial price cutting.

Petitioner proposes the following rule for determining predatory pricing in a primary-line Robinson-Patman Act case:

"substantial, unjustified, and discriminatory pricing below average variable cost with a reasonable prospect of recoupment."

Brief For The Petitioner 43. Petitioner further states that

"[a] reasonable prospect of recoupment can be inferred from the likelihood of effective oligopolistic pricing at supra-competitive levels, from a history of such pricing, or from the clear market analysis of a sophisticated and informed defendant."

Id. at n.56. Petitioner, however, proposes no definition of the "oligopolistic pricing" used in its test. In failing to define this term, petitioner proposes a rule lacking the definiteness needed to ensure that pro-competitive conduct is not deterred. *See supra* at 16-18.

It is far from clear that oligopoly can be precisely defined. *See* F. Scherer & D. Ross, *Industrial Market Structure and Economic Performance* 17 (3d ed. 1990) ("it is difficult to specify exactly where oligopoly shades into a competitive market structure"). Professor Areeda has recognized the difficulty of defining oligopoly:

"demonstrating that a few firms share monopoly power is highly complex. . . . one could define 'collusive' oligopoly in terms of concentration ratios, such

as four firms accounting for seventy-five percent or more of a market. Such concentration measures, however have serious defects. . . ."

Areeda & Turner, *Williamson on Predatory Pricing*, 87 Yale L.J. 1337, 1348 (1978). This difficulty makes petitioner's proposed rule unworkable.¹² It would inject an unwanted element of risk into vigorous price competition by encouraging competitor lawsuits aimed at restraining aggressive pricing. *See* Baumol & Ordover, *supra*, at 254 ("obscurity and ambiguity are convenient tools for those enterprises on the prowl for opportunities to hobble competition. As we know, it is not always necessary to win cases in order to blunt a rival's competitive weapons").

But even a workable definition of oligopoly cannot solve the problems that petitioner's proposal presents. According to some economists, almost 50% of all U.S. manufacturing sectors are considered oligopolistic. Scherer & Ross, *supra*, at 82. This enormous segment of American industry would need to think twice about whether or not to engage in vigorous price competition. Any firm in this segment, with no matter how small a market share, that decides to cut its prices would expose itself to the threat of a treble-damages lawsuit by an injured competitor. Moreover, such a firm would risk losing a lawsuit, for economists and academicians can undoubtedly spin out a theory of recoupment to fit almost any situation.¹³ In

¹² Not only is it difficult to define oligopoly, it is also difficult to determine whether oligopolists will engage in "cooperative behavior [or] gravitate towards price warfare. . . . Recognizing the wide range of behavior and theoretical predictions, some economists have asserted that the oligopoly problem is indeterminate." Scherer & Ross, *supra*, at 199. Petitioner's rule, which would require juries to predict the "likelihood of effective oligopolistic pricing," is unworkable for this additional reason.

¹³ Judge Easterbrook has compellingly stated the case against permitting an overzealous search for anti-competitive conduct in a category of conduct that primarily benefits competition (such as price cutting):

these circumstances, the firm likely would forego the price cut, depriving consumers of the benefit of lower prices.

The potential cost to consumers, moreover, is not outweighed by the purported benefits of petitioner's rule. Predatory pricing by a potential monopolist is exceedingly rare and difficult to execute successfully because the predator has little or no assurance that the losses it incurs can ever be recouped. *Matsushita*, 574 U.S. at 589. Predatory pricing by one firm in an oligopoly (if it exists at all) must be far rarer, and incalculably more difficult to execute successfully, because the predator has much less of an assurance that its losses can be recouped. See Areeda & Turner, *Williamson on Predatory Pricing, supra*, at 1348 ("uncertain as the profitability of limit-pricing behavior may be for a monopolist, it is even more risky for a firm facing existing rivals accounting for forty percent of the market . . ."); cf. *Matsushita*, 574 U.S. at 592-93 (noting difficulty of recoupment through explicit agreement among competitors). There is thus little danger that by rejecting petitioner's proposed rule and affirming the Fourth Circuit the Court will permit substantial anti-competitive activity to go unpunished.

"the world of economic theory is full of 'existence theorems'—proofs that under certain conditions ordinarily-beneficial practices could have undesirable consequences. But we cannot live by existence theorems. The costs of searching for these undesirable examples are high. The costs of deterring beneficial conduct (a by-product of any search for the undesirable examples) are high. When most examples of a category of conduct are competitive, the rules of litigation should be "stacked" so that they do not ensnare many of these practices just to make sure that the few anticompetitive ones are caught."

Easterbrook, *supra*, at 15 (emphasis added); see also A. A. Poultry, *supra*, 881 F. 2d at 1403-04 ("courts should treat with great skepticism complaints by competitors who are injured by the low prices that customers adore. . .").

CONCLUSION

The judgment of the Fourth Circuit Court of Appeals should be affirmed.

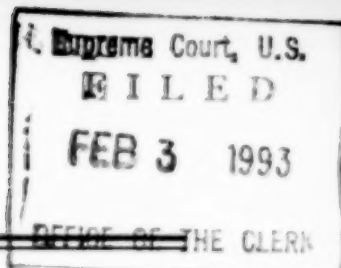
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No. 92-466

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1992

LIGGETT GROUP INC., NOW NAMED BROOKE GROUP LTD,
Petitioner,

v.

BROWN & WILLIAMSON TOBACCO CORPORATION,
Respondent.

On Writ of Certiorari to the United States
Court of Appeals for the Fourth Circuit

**BRIEF OF ITT CORPORATION
AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS**

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INTEREST OF THE AMICUS CURIAE

Amicus is ITT Corporation who, as the former parent of Continental Baking Company, has been embroiled since 1971 in federal court litigation concerning two price cuts on one item in Continental's bread line. *Wm. Inglis & Sons Baking Co. v. Continental Baking Co.*, 942 F.2d 1332 (9th Cir. 1991) ("*Inglis II*"). Pursuant to Supreme Court Rule 37, ITT respectfully submits this brief in favor of affirmance.

It was only in August of 1991 — twenty years after the complaint was filed — that the Ninth Circuit finally decided that Continental's two price cuts in the early 1970's did not violate Section 2 of the Sherman Act, or Section 2(a) of the Robinson-Patman Act. *Id.* at 1336-37. ITT has an obvious interest in ensuring that it does not suffer similar litigation in the future.

SUMMARY OF ARGUMENT

This case presents the Court with an opportunity to adopt needed legal rules to govern predatory pricing cases. Under current law, firms make competitive price cuts at considerable hazard of long and expensive litigation. A reversal in this case would necessarily endorse legal rules that would have severe inhibiting effects on price competition by threatening companies that cut prices with interminable and expensive litigation.

An affirmance would give the Court the opportunity to lessen the anticompetitive potential of so-called predatory pricing cases by endorsing the basic legal propositions argued in this brief — (1) that the subjective intent of the defendant should be irrelevant, (2) that prices above marginal or incremental cost should be presumptively legal, and (3) that only a defendant who is likely to obtain monopoly power could reasonably hope to recoup its investment in a predatory campaign.

ARGUMENT

INTRODUCTION

National policy encourages firms to compete vigorously, particularly on the basis of price. Through this dynamic competitive process, inefficient competitors fail and stronger competitors emerge. If a firm develops a better product and its competitors cannot respond, it may lawfully, albeit temporarily, obtain a monopoly. Price competition is no different. A firm may cut price and expand output to meet the entire demand if it develops the means to bring a competitive product to market at a lower price. See *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990) ("prices that are below 'market price' or even below the costs of a firm's rivals, 'are not activity forbidden by the antitrust laws'"). On the contrary, "it is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition." *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 116 (1986).

As most recently stated by the Court, "[t]he purpose of the [antitrust laws] is not to protect businesses from the working of the market; it is to protect the public from the failure of the market." *Spectrum Sports, Inc. v. McQuillan*, 61 U.S.L.W. 4123, 4127 (Jan. 25, 1993). Antitrust law does not target "conduct which is competitive, even severely so." *Id.* Only "conduct which unfairly tends to destroy competition itself" is condemned. *Id.*

Imposing antitrust liability for reducing price may serve only to prevent more efficient firms from challenging less efficient rivals, effectively turning antitrust on its head. Indeed, if markets worked perfectly there would be no need for antitrust to be concerned with price cutting. As soon as a predator attempted to profit from the failure of his competitors by restricting output and raising price, new entrants would emerge to take advantage of those high profits.

However, markets are not perfect, and this Court has thus recognized that on rare occasions price cuts may eliminate equally efficient firms from the market, and entry barriers might enable the price cutter to exercise substantial market power for some time. Although theoretically price cutting may thus cause competitive harm, this Court has often recognized that such "predatory pricing schemes are rarely tried, and even more rarely successful." *Cargill*, 479 U.S. at 122 n.17 (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986)). "[T]he success of such schemes is inherently uncertain: the short-run loss is definite, but the long-run gain depends on successfully neutralizing the competition." *Matsushita*, 475 U.S. at 589. In addition to the uncertainty of achieving the monopoly power needed to recoup short-run losses, a predator must also manage to retain that power "for long enough both to recoup the predator's losses and to harvest some additional gain." *Id.*

Courts must take great care to ensure that "a rule or precedent that authorizes a search for a particular type of undesirable pricing behavior [should not be permitted to] discourag[e] legitimate price competition." *Id.* at 594; see *Cargill*, 479 U.S. at 121 n.17. "[M]istaken inferences in cases such as this one are especially costly, because they chill the very conduct the antitrust laws are designed to protect." *Matsushita*, 475 U.S. at 594. Firms that make an honest business judgment that they could increase profits by expanding output and reducing price should not be compelled to hesitate because of fear that they will have to defend their action in the courts through years of antitrust litigation. "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition." *Atlantic Richfield*, 495 U.S. at 340.

It remains for the Court to incorporate its concerns for vigorous price competition into the legal rules applicable to

claims of predatory pricing and, specifically, the evidence necessary to enable a plaintiff to reach the jury. Amicus urges this Court to hold that objective facts alone are relevant to distinguishing vigorous price competition from the rare instance of truly predatory pricing. Evidence of defendant's subjective intent should never be relevant in these cases since all business rivals necessarily hope to increase their sales at the expense of their competitors' sales when they reduce price.

The relevant objective facts relate to defendant's costs, and to its market position. Plaintiff should be required to show that the added out-of-pocket costs that defendant incurred in making the sales complained of exceeded the revenues generated by those sales; *i.e.*, that defendant's short-run marginal costs exceeded marginal revenue. Plaintiff should also be required to prove that the low prices complained of had resulted, or would result, in market power sufficient to enable the defendant to prevent price competition for a period long enough to more than recoup out-of-pocket losses incurred during the period of the alleged predation.

Adoption of these objective standards would provide the lower courts with the means necessary to control this wasteful (practically no plaintiff ever recovers), and obviously competition-inhibiting, litigation.

I. EVIDENCE OF INTENT SHOULD PLAY NO ROLE IN EVALUATING A FIRM'S DECISION TO CUT PRICE.

Antitrust law seeks to punish practices that harm competition, not competitors. *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962). Indeed, it encourages firms to "harm" their competitors in order to attract more consumers to their own products. In the context of agreements in restraint of trade, for example, a price-fixing

agreement among all firms in the market harms competition, but benefits the conspiring competitors.

When dealing with single firm behavior where there is no clear suppression of competition, the distinction is often more difficult. A large firm's refusal to deal with a rival, or a decision to cut price, surely harms the competitor, but may actually increase competition. When dealing with some types of potentially anticompetitive practices (e.g., refusals to deal), the firm's intent may help courts to distinguish between procompetitive and anticompetitive behavior.¹

In price-cutting cases, however, intent should be irrelevant to the analysis. See *A.A. Poultry Farms, Inc. v. Rose Acre Farms, Inc.*, 881 F.2d 1396, 1401 (7th Cir. 1989), *cert. denied*, 494 U.S. 1019 (1990); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 232 (1st Cir. 1983); P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 714.2 at 677-78 (Supp. 1992). To be sure, a firm engaged in willful predatory pricing intends to harm its competitors, but so does a firm whose price cuts are not "predatory." A firm's goal in cutting price is always to expand its own output as much as possible at the expense of its competitors, and an attempt to exclude rivals is thus fairly characterized as predatory only if the attempt is grounded "'on some basis other than [superior] efficiency.'" *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605 (1985) (quoting R. Bork, *The Antitrust Paradox* at 138 (1978)).

¹ For example, a firm operating a ski mountain may refuse to sell a joint lift ticket with another ski company because it believes that the facilities on the other company's mountain are unsafe. Cf. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 609-10 (1985). Such a decision could encourage the competitor to improve the quality of its equipment, benefiting the competitive process. Conversely, a firm could refuse to deal simply in hopes of driving the other from the market. The firm's intent has obvious relevance to a court or jury attempting to draw this distinction.

In this case, Liggett argues that various internal documents demonstrate that B&W offered volume discounts in hopes of discouraging Liggett from engaging in price competition. Brief for Petitioner ("Pet. Br.") at 37. But this evidence of intent provides no relevant information about the issues of concern under the antitrust laws. If B&W could charge lower prices and still recover its added costs, or if B&W would not be able to prevent price competition after its allegedly predatory campaign, consumers benefit both in the short- and the long-term, and B&W's actions should not be discouraged by the threat of antitrust sanction.

The issue for the courts is thus not whether B&W intended to increase its own profits by disciplining Liggett, but whether it sought to do so through anticompetitive means. When price cutting is the charge, conduct is anticompetitive only if costs exceed revenues so that equally efficient rivals are threatened, and if the defendant would have sufficient market power after the predation period to permit it at that time to restrict output and raise price long enough to recover the losses incurred by reason of its low prices. Evidence of subjective intent does nothing to elucidate these issues.

II. AN ANTITRUST PLAINTIFF SHOULD BE REQUIRED TO DEMONSTRATE THAT THE DEFENDANT'S PRICE WAS LESS THAN THE INCREMENTAL COST OF PRODUCING THE ADDITIONAL UNITS IT WAS ABLE TO SELL BECAUSE OF ITS LOWER PRICE.

Since *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967), indicated that a cost/price relationship could be used by plaintiffs in predatory pricing cases to prove anticompetitive effect, the lower courts have been left to "struggle with the appropriate price-cost relation." *A.A. Poultry Farms*, 881 F.2d at 1400. Questions have included what cost is relevant, what is its evidentiary impact, and what products are to be included in the computation. Each of these

questions is presented by Petitioner's claim. None apparently has been addressed to date in this litigation.

A. Predatory Pricing Cases Should Not Reach The Jury Where Prices Exceed Short-Run Marginal, or Incremental, Cost.

Beginning with *Utah Pie* in 1967, and with considerable impetus from an influential article a few years later, P. Areeda & D. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697 (1975), plaintiffs in predatory pricing cases have relied almost exclusively on evidence of defendant's cost/price relationship to carry their burden of proving competitive injury. The lower courts have not, however, been afforded directions by this Court as to the type of cost evidence that is probative of a lessening of competition.² Without this guidance, the result has been decisions in the different circuits, sometimes conflicting,³ which have left trial courts without the analytical framework necessary to separate those cases which should reach juries and those that should not.

Several circuits require that plaintiff prove that defendant's prices were below the incremental cost of making the sales complained of. *E.g.*, *Inglis II*, 942 F.2d at 1336; *Northeastern Tel. Co. v. AT&T*, 651 F.2d 76 (2d Cir. 1981), *cert. denied*, 455 U.S. 943 (1982); *D.E. Rogers Assocs., Inc.*

² The Court has simply suggested that a low price could be evidence of predatory behavior if it is "below the level necessary to sell" the product or "below some appropriate measure of cost," *Matsushita*, 475 U.S. at 585 n.8, and has declined "to consider whether recovery should ever be available . . . when the pricing in question is above some measure of incremental cost" [. . .] or whether above-cost pricing coupled with predatory intent is ever sufficient to state a claim of predation." *Cargill*, 479 U.S. at 117-18 n.12 (quoting *Matsushita*, 475 U.S. at 585 n.9).

³ This Court twice noted in 1986 the conflict in the circuits as to what the relevant cost measure is. *Cargill*, 479 U.S. at 117 n. 12; *Matsushita*, 475 U.S. at 585 n.9. The conflict remains.

v. *Gardner-Denver Co.*, 718 F.2d 1431, 1435 (6th Cir. 1983), *cert. denied*, 467 U.S. 1242 (1984). At least one circuit has declined to define the relevant cost measure, *Barry Wright Corp.*, 724 F.2d at 233 (1st Cir. 1983), and others have held that which costs were variable is a jury question. E.g., *McGahee v. Northern Propane Gas Co.*, 858 F.2d 1487, 1504 n.38 (11th Cir. 1987), *cert. denied*, 490 U.S. 1084 (1989); *Wm. Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1038 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982) ("*Inglis I*"); *Kelco Disposal, Inc. v. Browning-Ferris Indus.*, 845 F.2d 404, 408 (2d Cir. 1988), *aff'd on other grounds*, 492 U.S. 257 (1989); *Adjusters Replace-a-Car, Inc. v. Agency Rent-a-Car, Inc.*, 735 F.2d 884, 891 n.6 (5th Cir. 1984), *cert. denied*, 469 U.S. 1160 (1985).⁴ In the present case, the court apparently followed a categorical approach as advocated in 3 P. Areeda & D. Turner, *Antitrust Law* ¶ 715, at 173 (1978); App. 30a, n.29. Under this approach, costs which are commonly classified as variable over some appreciable term are considered the relevant costs, without regard to whether they increased because of the complained of sales.

⁴ This approach has been cogently described as the "approach with the greatest potential for insupportable results" and "entirely unworkable". P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 711.1d at 635 (Supp. 1992). The authors go on to point out that, if the cost standard is left to the jury, "[t]hese cases, already complex enough, would thereby be complicated beyond the point of understanding. Moreover, if the instructions are as general as they are likely to be, the jury will not know what to do, and the legal system will be no better off than in the days when predatory pricing claims were submitted to juries without any intelligible governing legal standard." *Id.*

The experience in *Inglis* and other cases, including apparently the instant case, makes it plain that it is not a daunting task for plaintiff's "expert" to identify sufficient categories of defendant's costs as "variable" to yield an average variable cost figure higher than price. Defendant's "expert" then does the opposite. Juries are totally unequipped to deal with such testimony. It should be a function of the trial court to identify, as a matter of law, the relevant cost standard.

Effective administration of predatory pricing cases requires delineation by this Court of those costs that are relevant to the cost/price comparison, and what the evidentiary impact of this evidence is.

1. *Appropriate Measure of Cost.* Short-run "marginal" and "incremental" costs are terms used interchangeably to refer to the costs associated with the last unit of output.⁵ Prices that are above marginal, or incremental, cost add to profit; the revenue they produce exceeds the costs incurred in producing the revenue. These prices thus add to profit. In the short run, which is all the courts can hope sensibly to assess, *Northeastern Tel.*, 651 F.2d at 87 n.15, prices above incremental cost do not require recoupment. "Marginal cost pricing . . . fosters competition on the basis of relative efficiency. Establishing a pricing floor above marginal cost would encourage underutilization of productive resources and would provide a price 'umbrella' under which less efficient firms could hide from the stresses and storms of competition." *Id.* at 87.

Short-run marginal, or incremental, cost thus provides a useful objective standard by which to measure a plaintiff's claim that defendant's conduct was predatory. It is a standard which recognizes that no added costs are incurred by utilizing idle resources, and which threatens only those firms that "are relatively inefficient." *Atlantic Richfield*, 495 U.S. at 337-38 n.7. This standard also provides reliable circumstantial evidence of intent since there are normally many reasons to sell at prices above marginal cost, and virtually none to sell at prices beneath it.

⁵ "Marginal cost, which is the incremental cost of producing the next unit, is the 'competitive standard'." P. Areeda, *Predatory Pricing* (1980), 49 *Antitrust L.J.* 897, 902 (1980). What is the "next unit" will depend on the transaction that is complained of.

Contrary to expressions in some decisions and legal literature that incremental costs "can seldom be measured in litigation," P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 715 at 699 (Supp. 1992); *Adjusters Replace-A-Car*, 735 F.2d at 889, such costs are commonly used by firms in many contexts (e.g., bidding on new projects) and are quite easy to calculate. See, e.g., C. Horngren G. Foster, *Cost Accounting: A Managerial Emphasis* 414 (7th ed. 1991); A. Matz & M. Usry, *Cost Accounting: Planning and Control* 624 (8th ed. 1984). For example, in *Inglis II*, the record contained substantial evidence that both parties, and every other wholesale baker in the market, were able to compute precisely its marginal costs of selling one pound private label bread, the item in issue in that case. The record in *Utah Pie* also reflected Continental's marginal cost of producing frozen fruit pies in California, shipping them to Salt Lake City, and selling them there. *Utah Pie*, 386 U.S. at 698. The court also had the defendant's marginal cost available to it in *Marsann Co. v. Brammall*, 788 F.2d 611 (9th Cir. 1986). See also *D.E. Rogers Assocs.*, 718 F.2d at 1437.

In the present case, Liggett appears to have made no effort to prove that prices were below the incremental costs associated with B&W's high volume discounts. These incremental costs were not considered by the courts below, and apparently were never computed. Instead, both parties seem to have assumed that an average variable cost figure computed by adding up the costs carried on the defendant's books in various categories, and dividing by total output, was the proper cost standard. This approach, as noted, yields nothing but conflicting testimony by "experts" — as in this case — which is totally beyond the ability of juries to appraise, and results in a cost figure that would not have been considered in making the business decision complained of.

2. The Significance of the Cost/Price Comparison. The Eleventh Circuit has held explicitly that prices below total cost, but above marginal cost, may be considered as

circumstantial evidence of predatory intent. *McGahee*, 858 F.2d at 1503. A number of other circuits reach a comparable result by permitting evidence of prices above incremental cost to be considered, along with other evidence, as evidence of predation. *Inglis I*, 668 F.2d at 1035; *Henry v. Chloride Inc.*, 809 F.2d 1334, 1346 (8th Cir. 1987); *Chillicothe Sand & Gravel Co. v. Martin Marietta Corp.*, 615 F.2d 427 (7th Cir. 1980); *D.E. Rogers Assocs.*, 718 F.2d at 1437. The significance of the cost evidence was expressly left open in *Barry Wright Corp.*, 724 F.2d at 233, and one circuit has even held that evidence of prices above full cost can be probative of predatory pricing. *Transamerica Computer Co. v. I.B.M. Corp.*, 698 F.2d 1377 (9th Cir.), *cert. denied*, 464 U.S. 955 (1983). Other circuits have disagreed. *Barry Wright Corp.*, 724 F.2d at 233; *Arthur S. Langenderfer, Inc. v. S.E. Johnson Co.*, 729 F.2d 1050 (6th Cir.), *cert. denied*, 469 U.S. 1036 (1984).

Permitting plaintiffs to reach juries simply on evidence that defendant's prices were below total cost but above incremental cost, or on that evidence plus evidence of defendant's intent to take sales away from its competitors, is bad law and bad social policy. It is bad law because circumstantial evidence that logically supports two conflicting inferences proves neither. See *Matsushita*, 475 U.S. at 596-97; *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 763-64 (1984). Because there are so many normal business reasons to sell at prices that recover costs incurred, the fact is that profit-maximization is a far more logical inference to draw from prices above incremental cost than is an inference of predatory intent. And evidence of an intent to take sales away from defendant's competitors should not be enough to permit the opposite inference since, as noted, such an intent is a normal by-product of the competitive process.

Permitting juries to condemn prices above incremental cost is bad social and economic policy, not only because it greatly encourages this type of litigation, but also because it

must inevitably inhibit such normal output-enhancing competitive efforts as promotional pricing and maximum utilization of resources. By presuming, as a matter of law, that prices above marginal cost do not raise antitrust concerns, the courts would ensure that the basic antitrust purpose -- to enhance output to the benefit of consumers -- is furthered.

B. The Record In This Case Is Insufficient To Permit A Predatory Pricing Case To Reach The Jury.

For at least two reasons, the record in this case is insufficient to permit a jury to infer predatory intent. To support a rational inference of predatory intent, the cost/price evidence obviously must reflect the realities of the choice confronting the businessman charged with harboring such intent. This means that the costs that are compared to the price must be those that foreseeably would increase as a result of charging the allegedly predatory price.

This record appears to contain no evidence at all from which the Court could ascertain the added costs that B&W foreseeably would incur by reason of its decision to grant discounts to high-volume wholesalers. Liggett's brief cites no such evidence, and merely quotes one opaque passage as an "admission" of B&W's expert:

"Pretax trading profit was negative. Therefore, if you disregard financial consequences other than direct sales revenue, [*i.e.*, reduced taxes on other profits] in what you refer to as price the answer would be that prices are below average variable cost."

Pet. Br. at 14. In addition, the trial court's opinion recites that there was testimony of an expert hired by Liggett that

B&W's prices on its generic line were below its average variable costs. App. 45a.

The case appears to have been tried by both sides on the theory that the costs relevant to Liggett's predatory pricing charge were average variable costs, defined in some categorical manner, App. 30a, n. 29, on B&W's entire generic product line. Nowhere in the briefs or opinions is there any statement as to what costs were included in the two sides' calculations, and there is no evidence at all that either side focused on the added costs that were incurred as a result of the sales of black-and-white cigarettes to high volume wholesalers.

The second reason why the evidence relied upon by Liggett does not rationally support a likelihood of competitive injury is that the price it complains of was limited to only one item in the product line of both B&W and of Liggett. Plainly, B&W's low price on just black-and-white cigarettes could not reasonably be found to have been intended to drive out a full-line producer such as Liggett.⁶ The lower courts and the Federal Trade Commission have consistently rejected inferences of competitive injury where plaintiff's evidence of a cost/price relationship was limited to one item in the competitors' product lines. *Morgan v. Ponder*, 892 F.2d 1355, 1361-62 (8th Cir. 1989); *Bayou Bottling, Inc. v. Dr. Pepper Co.*, 725 F.2d 300, 305 (5th Cir.), *cert. denied*, 469 U.S. 833 (1984); *Buffalo-Courier Express, Inc. v. Buffalo Evening News, Inc.*, 601 F.2d 48, 57 (2d Cir. 1979); *International Tel. & Tel. Corp.*, 104 F.T.C. 280, 425-27 (1984).

⁶ Only if the one low-priced item was such an important part of the entire product line that it resulted in the entire line being sold below the relevant cost measure could the one price alone rationally support an inference of predation. *Janich Bros., Inc. v. American Distilling Co.*, 570 F.2d 848, 856-57 (9th Cir. 1977), *cert. denied*, 439 U.S. 829 (1978).

The proof in this case appears to have failed to satisfy either of these criteria. Reversal of the decision below could only be read by bench and bar to hold that "below cost" means below the total of various categories of cost that are usually considered "variable" (over some unstated period of time longer than the short run), divided by output. Reversal would also necessarily be read as endorsing plaintiffs' consistent efforts in these cases to base their charges on only the lowest priced item in the product line. Reversal on this record would thus virtually guarantee every plaintiff access to a jury in a case alleging predatory pricing.

III. AN ANTITRUST PLAINTIFF SHOULD BE REQUIRED TO DEMONSTRATE THAT A PRICE-CUTTING DEFENDANT OBTAINED MONOPOLY POWER, OR CAME DANGEROUSLY CLOSE TO MONOPOLIZING THE RELEVANT MARKET, IN ORDER TO PROVE THAT PRICE CUTTING VIOLATED THE ANTITRUST LAWS.

The ultimate question in any price-cutting case is whether competition could be harmed. Unlike other potentially anticompetitive practices, price cutting always benefits consumers in the short run. "[I]ndeed, 'cutting prices in order to increase business often is the very essence of competition' *Atlantic Richfield*, 495 U.S. at 338 (quoting *Matsushita*, 475 U.S. at 594). To determine whether price cutting may have long-run anticompetitive consequences, courts must ask whether the alleged predator could recoup the cost of its allegedly predatory campaign. If not, the behavior benefits consumers, irrespective of the price/cost ratio and should not be deterred by the antitrust laws. *A.A. Poultry*, 881 F.2d at 1401.

One of the basic issues raised in this case is what proof is required to demonstrate that recoupment was plausible, *i.e.*, that an injury to competition either occurred or was

dangerously likely. Liggett contends that evidence that prices rose on the black-and-white items in the line of generic cigarettes, combined with internal documents in which B&W stated that it would profit if prices rose, is sufficient evidence that B&W's price cutting threatened competition.

This Court should reject Liggett's theory of competitive injury because it would permit the jury to infer predatory pricing any time prices rose following a price war (which they always do), and the defendant had foreseen that result. The mere fact that prices rise in no way indicates that a predatory campaign was successful, and permitting juries to so infer would surely discourage procompetitive behavior.

Amicus urges this Court to adopt, in accordance with numerous courts of appeal that have considered the issue,⁷ the standard for competitive injury that is applicable in Section 2 Sherman Act cases. This Court has taken great care "to avoid constructions of §2 which might chill competition, rather than foster it." *Spectrum Sports*, 61 U.S.L.W. at 4127. Recognizing the difficulty inherent in distinguishing "robust competition from conduct with long-term anticompetitive effects," the Court has carefully limited liability in such cases to instances of monopolization or a dangerous threat thereof. *Id.* "Judging unilateral conduct in this manner reduces the risk that the antitrust laws will dampen the competitive zeal of a single aggressive entrepreneur." *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984).

⁷See *Inglis II*, 942 F.2d at 1337; *Stitt Spark Plug Co. v. Champion Spark Plug Co.*, 840 F.2d 1253, 1255 (5th Cir.), *cert. denied*, 488 U.S. 890 (1988); *Henry v. Chloride*, 809 F.2d at 1345; *D.E. Rogers Assocs.*, 718 F.2d at 1439; *Pacific Eng'g & Prod. Co. v. Kerr-McGee Corp.*, 551 F.2d 790, 798 (10th Cir.), *cert. denied*, 434 U.S. 879 (1977); *Jays Foods, Inc. v. Frito-Lay, Inc.*, 656 F. Supp. 843, 846 (N.D. Ill. 1987); *aff'd without opinion*, 860 F.2d 1082 (7th Cir. 1988), *cert. denied*, 489 U.S. 1014 (1989).

The Court's reasoning is no less compelling in a predatory pricing case under Section 2(a) of the Robinson-Patman Act. Although "the Sherman Act speaks of attempt to monopolize, while Robinson-Patman is aimed at lessening of competition," the two linguistic formulations target the same result. *Henry v. Chloride*, 809 F.2d at 1345. "[I]n order to lessen competition, a defendant must be able to create a real possibility of both driving out a rival by loss-creating price cutting and then holding on to that advantage to recoup losses. . . . [I]f other rivals can with reasonable ease take the place of any competitors knocked out -- competition is not seriously or permanently damaged." *Id.* Only monopoly power can render recoupment a reasonable possibility.

B&W had no hope of obtaining monopoly power (or of agreeing to share such power with the larger firms in the industry). Liggett argues, however, that when the defendant is a participant in an oligopoly, even a firm without monopoly power may substantially lessen competition by disciplining a price cutter and returning the industry to its prior oligopolistic pricing structure. Without a substantial prospect that the predator could obtain monopoly power or come dangerously close to doing so, however, the possibility that defendant priced as it did on the assumption that it could recoup its investment is pure speculation without an evidentiary basis. Any of the other firms in the market could at any time reduce price. That they might do so is particularly likely where, as in the tobacco industry, there is excess capacity, the utilization of which will increase profits. Indeed, this appears to have happened as firms entered the generic cigarette market and introduced "sub-generic" brands priced even lower than black-and-white cigarettes had been. J.A. 326.

Given the grave risks inherent in a predatory campaign by a relatively small participant in an oligopoly, it is implausible that one would try. Moreover, the legal rule that Liggett requests would have the perverse results of

discouraging the sort of price competition initiated by B&W in this case, and of encouraging this type of litigation. Thousands of companies in hundreds of industries with a small number of participants could be forced to submit to burdensome discovery and a jury trial for instituting a price war and later increasing prices. The cost to the economy of such disruption is surely not worth the benefit of preventing the rare predatory campaign in which an oligopolistic market simply returns to business as usual.

Liggett also argues that Congress explicitly rejected the Sherman Act competitive injury standard by incorporating incipency language into Section 2(a) of the Robinson-Patman Act that is not present in Section 2 of the Sherman Act. Pet. Br. at 26. For this reason, Liggett contends, the injury to competition required in predatory pricing cases under the Robinson-Patman Act must be less than that required under the Sherman Act. But this Court has long maintained that the broad language of the Robinson-Patman Act must be reconciled "with the broader antitrust policies that have been laid down by Congress." *Automatic Canteen Co. v. FTC*, 346 U.S. 61, 74 (1953); see *Great Atlantic & Pacific Tea Co., v. FTC*, 440 U.S. 69, 80 n.13 (1979). Moreover, the Court recently applied the well-established Sherman Act standard to determine whether competitive injury was likely to result from predatory pricing under Section 7 of the Clayton Act, a statute containing incipency language virtually identical to that in Section 2(a) of the Robinson-Patman Act. See *Cargill*, 479 U.S. 104.

In *Cargill*, the plaintiff contended that, if a proposed merger went forward, the merged firm ("Excel") "would bid up the price it would pay for cattle, and reduce the price at which it sold boxed beef. Although such a strategy . . . would reduce Excel's profits, Excel's parent corporation had the financial reserves to enable Excel to pursue such a strategy." *Cargill*, 479 U.S. at 114. The plaintiff argued that eventually "smaller competitors lacking significant

reserves and unable to match Excel's prices would be driven from the market; at this point Excel would raise the price of its boxed beef to supracompetitive levels, and would more than recoup the profits it lost during the initial phase." *Id.*

Although the Court in *Cargill* did not take a position on the appropriate price/cost ratio, it emphasized that the evidence would likely have been insufficient to establish predatory pricing, because the likelihood of recoupment was remote. Without a share of market capacity in the 60% range or "a plan to collude," the Court stated, the defendant "would harm only itself by embarking on a sustained campaign of predatory pricing." *Id.* at 120 n.15. Justice Stevens, in dissent, asserted the view — which the majority did not dispute — that the Court's decision "in practical effect" holds that predatory pricing could not be shown in a Section 7 case "unless the actual or probable conduct of the merged firms would establish a violation of the Sherman Act." *Cargill*, 479 U.S. at 123 n.1 (Stevens, J., dissenting).

CONCLUSION

For the reasons set forth above, the Court should adopt objective and clear legal standards to govern predatory pricing cases and affirm the decision of the Fourth Circuit.

Respectfully submitted,

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